

AGENDA — April 18, 2001 Business Taxes Committee Meeting
Proposed Regulatory Change Regarding Bad Debt Deductions for Tax Paid on
Transactions on Uncollectable Accounts Held By a Lender (Regulation 1642, Bad Debts)

<p>Action 1 — Consent Items</p> <p>Adopt proposed amendments to Regulation 1642 as agreed by staff and industry.</p> <p>Exhibit 2, Pages 1-16</p>	<ol style="list-style-type: none">1. Incorporate the provisions of Revenue and Taxation Code sections 6055 & 6203.5 that allow a bad debt deduction to be claimed on accounts receivable that have been sold without recourse. The bad debt deduction may be claimed by either the retailer or lender pursuant to an election filed with the Board.2. Provide a list of the required elements of an election.3. Update the appendices used to calculate the bad debt loss.4. Add and change language to clarify existing policies.5. Make minor technical changes throughout the regulation to be consistent with current regulatory format.
<p>Action 2 — Authorization to Publish</p>	<p>Authorize publication of the proposed amendments to Regulation 1642 as adopted in the above action.</p> <p>Operative Date: Added subdivisions (h)(3) and (i) are operative January 1, 2001 and apply to taxes remitted on or after January 1, 2000. Other changes have no operative date.</p> <p>Implementation: Implementation will take place 30 days following approval by the Office of Administrative Law.</p>

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Action Item	Regulatory Language Proposed by Staff
<p>Action 1 - Consent Items</p> <p>Adopt proposed amendments to Regulation 1642.</p> <p>Exhibit 2, pages 1-16.</p>	<p>Regulation 1642. Bad Debts.</p> <p><i>Reference:</i> Sections 6055, and 6203.5, and 6451, Revenue and Taxation Code.</p> <p>(a) IN GENERAL. A retailer is relieved from liability for sales tax (Section 6055 of the Revenue and Taxation Code) or from liability to collect use tax (Section 6203.5 of the Revenue and Taxation Code) insofar as the measure of the tax is represented by accounts found worthless and charged off for income tax purposes <u>(which include circumstances where the retailer's income is reported on a related person's income tax return and the bad debt is charged off on that return) or, if the retailer is not required to file income tax returns and the retailer's income is not reported on another person's return,</u> charged off in accordance with generally accepted accounting principles. A retailer may claim a bad debt deduction provided that the sales tax, or amount of use tax, was actually paid to the state.</p> <p>This deduction should be taken on the return filed for the period in which the amount was found worthless and charged off for income tax purposes or, if the retailer is not required to file income tax returns, charged off in accordance with generally accepted accounting principles.</p> <p>Failure to take the deduction on the proper return will not in itself prevent the allowance of a refund measured by an amount for which a retailer could have taken a timely deduction provided a claim for refund is filed with the board within the limitation periods specified in Section 6902 of the Revenue and Taxation Code.</p> <p>(b) AMOUNT SUBJECT TO DEDUCTION.</p> <p>(1) NONTAXABLE RECEIPTS. If the amount of an account found to be worthless and charged off is comprised in part of nontaxable receipts such as interest, insurance, repair, or installation labor and other charges exempt from sales or use tax and in part of taxable receipts upon which tax has been paid, a bad debt deduction may be claimed only with respect to the unpaid amount upon which tax has been paid. In determining that amount, all payments and credits to the account may be applied ratably against the various elements comprising the amount the purchaser contracted to pay (pro rata method), or may be applied as provided in the contract of sale (contract method), <u>or may be applied by another method which reasonably determines the amount of the taxable receipts (alternative method).</u> When claiming a bad debt deduction or refund using an alternative method, the retailer must include a clear explanation of that method along with the claiming of the deduction or refund. After having applied payments and credits by either the pro rata method or the contract method, and having filed returns based on such application of payments and credits using one method and claiming a deduction or refund based on such method, a retailer shall not thereafter reapply the payments or credits by the using another method with respect to such losses previously claimed. so as to claim additional bad debts by way of deduction, credit or refund.</p>

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	<p>(2) EXPENSES OF COLLECTION. No deduction is allowable for expenses incurred by the retailer in attempting to enforce collection of any account receivable, or for that portion of a debt recovered that is retained by or paid to a third party as compensation for services rendered in collecting the account.</p> <p>(c) REPORTING. All retailers must report sales tax liability on an accrual basis. Bad debt deductions will not be disallowed retailers solely for the reason that they are a <u>retailer is</u> on a cash reporting basis for income tax purposes.</p> <p>(d) WORTHLESS ACCOUNTS SUBSEQUENTLY COLLECTED. If any accounts found worthless and charged off are is thereafter in whole or in part collected by the retailer, <u>in whole or in part, the taxable percentage of the amount so collected shall be included in the first return filed after such collection and tax shall be paid on such the amount of the tax thereon paid with the return. The same percentage of the account which the retailer claimed as an allowable bad debt deduction or refund shall be used to determine the taxable percentage of the recovery. The taxable percentage of any amounts received from a third party for the sale of an account after the retailer has found them to be worthless and has claimed a bad debt deduction or refund are regarded as amounts subsequently collected for purposes of this provision, and the retailer must include such amounts in the first return filed after receipt of such amounts and pay tax thereon.</u></p> <p>(e) RECORDS. In support of deductions or claims for credit <u>refund</u> for bad debts, retailers must maintain adequate and complete records showing:</p> <ul style="list-style-type: none"> (1) Date of original sale. (2) Name and address of purchaser. (3) Amount purchaser contracted to pay. (4) Amount on which retailer paid tax. (5) <u>The jurisdiction(s) where the local taxes and, when applicable, district taxes were allocated.</u> (6) All payments or other credits applied to account of purchaser. (67) Evidence that the uncollectible portion of gross receipts on which tax was paid actually has been legally charged off as a bad debt for income tax purposes <u>(whether or not the income tax return has yet been filed) or, if the retailer is not required to file income tax returns and the retailer's income is not reported on another person's return, charged off in accordance with generally accepted accounting principles.</u> (8) <u>The taxable percentage of the amount charged off as a bad debt properly allocable to the amount on which the retailer reported and paid tax. (See Appendix 1.)</u> <p>(f) <u>REPOSSESSIONS. ALLOWABLE METHODS OF COMPUTING LOSS.</u></p> <p>(1) IN GENERAL. When there is a repossession, a bad debt deduction is allowable only to the extent that the retailer sustains a net loss of gross receipts upon which tax has been paid. This will be when the amount of all payments and credits allocated to the purchase price of the merchandise, including the wholesale value of the repossessed article, is less than that price. Depending on whether <u>If the pro rata method or the contract method is used to apply payments, a retailer</u></p>

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	<p>incurs an allowable bad debt deduction if the wholesale value of the repossessed merchandise is less than the net contract balance (after excluding unearned insurance and finance charges) at the date of repossession, or (2) if <u>If the contract method is used to apply payments, a retailer incurs an allowable bad debt deduction if the wholesale value of the repossessed merchandise is less than the net merchandise contract balance at the date of repossession. <u>An alternative method of computing a bad debt loss may be used subject to approval by the Board which approval shall not be unreasonably withheld.</u></u></p> <p>—(2) COMPUTING LOSS ON REPOSSESSION—INFORMATION REQUIRED. The amount of net loss will be computed by deducting from the original sales price upon which tax has been paid, the amount of all payments, trade-in allowances or other credits applicable to such sales price, under the pro rata method or contract method, plus the amount for which a retailer, at the time of repossession, could acquire a similar article from a wholesaler.</p> <p>In order to compute an allowable deduction for repossessed merchandise, the following information is necessary:</p> <p>—(A) Date of sale.</p> <p>—(B) Cash sales price of the merchandise sold.</p> <p>—(C) Amount of charges for intangibles included in the cash sales price:</p> <p>—— 1. Sales tax reimbursement.</p> <p>—— 2. License fees, if a vehicle.</p> <p>—— 3. Installation labor, etc., for a fixture, furniture or heavy appliance.</p> <p>—— 4. Insurance.</p> <p>—— 5. Any other nontaxable charges except finance charges.</p> <p>—(D) Total cash sales price.</p> <p>—(E) Amount of down payment.</p> <p>—(F) Amount of cash sales balance.</p> <p>—(G) Finance charges.</p> <p>—(H) Contract balance.</p> <p>—(I) Payments on contract.</p> <p>—(J) Contract balance at date of repossession.</p> <p>—(K) Date of repossession.</p> <p>—(L) Date of payoff.</p> <p>—(M) Unearned finance charges.</p> <p>—(N) Amount of insurance rebate.</p> <p>—(O) Wholesale value of repossessed merchandise.</p> <p>—(P) Repossession loss per records.</p>

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	<p>(32) Method of Computing Loss--Pro Rata Method. <u>METHOD OF COMPUTING LOSS -- PRO RATA METHOD.</u></p> <p>(A) LOSS PER RECORDS. This is the net payoff less the wholesale value of the repossessed merchandise. The net payoff is the contract balance at the date of repossession less unearned finance charges and insurance rebates. The loss per records is the bad debt loss the retailer writes off for income tax purposes. An estimate of bad debt losses based in part upon the history of the business or industry averages, may not be used to claim bad debt deductions or refunds for sales and use tax purposes.</p> <p>(B) TAXABLE PORTION OF LOSS PER RECORDS. This is computed in two steps:</p> <p style="padding-left: 40px;">1. Allocation of down payment to merchandise. Sales price of merchandise divided by total cash selling price (includes all intangibles other than finance charges) less the insurance rebate multiplied by the down payment.</p> <p style="padding-left: 40px;">2. Taxable portion of loss per records. The unpaid balance of merchandise cost (sales price less down payment allocation per (1) above) divided by the contract balance less unearned finance charges and insurance rebates.</p> <p><u>The repossession loss per records as computed in (A) above, multiplied by the taxable portion of the loss, as computed in (B)2. above, results in the allowable bad debt deduction. (See Appendix 1 at end of regulation for example.)</u></p> <p><u>Only that portion of a bad debt loss attributable to the amount on which the retailer paid tax may be used to claim a bad debt deduction or refund for sales and use tax purposes. Even an account with all sales subject to tax may include some amounts on which tax was not paid, such as the tax or tax reimbursement charged to the consumer which is included in the account balance. The percentage of loss on which tax was paid for an account which is secured by the merchandise purchased, or which represents a single purchase of a significant amount, should be calculated on an actual basis. The percentage of loss on which tax was paid for accounts involving a large volume of small transactions may be calculated based on an analysis of the composition of the accounts receivable. All accounts of the retailer for which this calculation is made should use the same method of applying payments for the calculation (e.g., use FIFO for all accounts or use LIFO for all accounts). Examples using the pro rata method are attached as Appendices 1 and 2.</u></p> <p>(43) METHOD OF COMPUTING LOSS--CONTRACT METHOD. The allowable bad debt deduction is the net merchandise balance after payments and credits have been applied as provided by the contract, less the wholesale value of the repossessed merchandise, calculated by subtracting all payments and credits from the purchase price of the merchandise pursuant to the method of applying payments set forth in the applicable contract(s) with the customer and, to the extent the contract is silent on the method of applying payments, the loan accounting systems used by the retailer in the ordinary course of business, and from that amount subtracting the proceeds of the sale of any repossessed merchandise in accordance with (4) below.</p> <p>(54) DETERMINING THE WHOLESAL VALUE OF REPOSSESSED MERCHANDISE. One of the prerequisites in computing the loss on repossessed merchandise is determining the wholesale value thereof. The wholesale value of repossessed merchandise must be determined in order to calculate the allowable bad debt deduction, if any, for the</p>

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	<p><u>account. When the retailer sells the repossessed merchandise to a reseller in an arm's length transaction, the amount the retailer receives for the sale, less the direct cost of reconditioning the property prior to that sale and direct auction expenses paid to a third party, is the wholesale value. Otherwise, other sources must be used to determine the wholesale value. In the case of automobiles, information contained in industry-recognized wholesale and retail price guides will be acceptable are generally the best source of such information. Adjustments may should be made to the published wholesale prices in those instances where the automobile is in other than average condition.</u></p> <p>Establishing the wholesale value on of other types of repossessed merchandise, such as jewelry, furniture, appliances, etc., presents a more difficult problem <u>if the retailer does not sell the merchandise to a reseller in an arm's length transaction</u>. Each case must be considered on its own merits. Generally, <u>if the retailer places the repossessed property into resale inventory, the retailer should will be able to use the amount at which the merchandise is brought back into recorded in resale inventory as its wholesale value</u>. This amount should not, however, include any costs of repossessing, reconditioning, or other expense to put the merchandise in saleable condition.</p> <p>(65) CONSOLIDATION OF NUMEROUS REPOSSESSED ITEMS. Retailers who have several repossessions each reporting period will find it convenient and time saving to consolidate the pertinent data. When this is done, only one calculation for each set of transactions need be made to compute the allowable deduction. The consolidations may be made by using 15-column working paper with one column for each of the elements required to compute the deduction (see Appendix 2).</p> <p>Only those repossessions on which a loss is incurred should be scheduled. The taxpayer-retailer may quickly determine whether a particular transaction should be scheduled by comparing the net payoff with the wholesale value of the merchandise. If the net payoff is greater, a loss has been suffered and the transaction should be scheduled.</p> <p>(7) NET MERCHANDISE BALANCE. The term "net merchandise balance" as used herein means the amount remaining after all payments and credits have been deducted from the purchase price of the merchandise.</p> <p>(g) BAD DEBT LOSSES OTHER THAN REPOSSESSIONS. Allowable bad debt deductions <u>or refunds</u> also may arise from sales made on <u>an open account or on an unsecured installment-basis basis</u>. These The deduction or refund should be computed in substantially the same manner as those involving repossessions, (i.e., by prorating all payments or credits between the cash sales price of the merchandise on which the retailer paid tax and the intangible nontaxable charges or by applying all payments and credits as provided in the contract of sale and, if the contract is silent, the loan accounting systems used by the retailer in the ordinary course of business). No <u>deduction or claim for refund or credit</u> will be allowed in any period subsequent to the period in which a bad debt deduction is taken, based on a method of calculating the bad debt deduction different from that originally used in calculating the bad debt deduction.</p> <p>(h) SPECIAL SITUATIONS.</p>

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	<p>(1) BAD DEBT DEDUCTIONS TO <u>FOR</u> PERSONS OTHER THAN THE RETAILER <u>OR</u> LENDER.</p> <p>(A) A successor who pays full consideration for receivables acquired from the predecessor is entitled to a bad debt deduction to the same extent that the predecessor would have been entitled had the predecessor continued the business. <u>A “successor” for purposes of this provision is one who is required by Revenue and Taxation Code section 6811 to withhold sufficient of the purchase price of the subject business to cover amounts due from the seller of the business under the Sales and Use Tax Law. A predecessor may not claim a bad debt deduction for any transaction or account for which a successor is entitled to a bad debt deduction under this provision.</u></p> <p>(B) A-Except as provided in subdivision (h)(1)(A) and subdivision (i), a purchaser of receivables, other than a successor, cannot obtain claim a bad debt deduction on or refund for accounts which are not collected.</p> <p>(C) A retailer who sells receivables with recourse so that the retailer will bear any bad debt loss on them is entitled to a bad debt deduction to the same extent as if the receivables had not been sold. The fact that a retailer sells receivables at a discount, however, with or without recourse, does not in itself entitle the retailer to a bad debt deduction to the extent of the discount.</p> <p>(2) BAD DEBTS OF CONSTRUCTION CONTRACTORS. Subparagraph (b)(2)(A)2. of Section 1521 of Title 18 recognizes two instances when a contractor (other than a United States construction contractor as defined in section (b)(1)(A) of Section 1521 of Title 18) is considered to be selling materials prior to installation. In those two instances only, when the contractor reports and pays tax on the sales price of the materials and the receivable is thereafter found to be worthless and is charged off for income tax purposes, a bad debt deduction may be taken by the contractor.</p> <p>Since a contractor (other than a United States construction contractor as defined in section (b)(1)(A) of Section 1521 of Title 18 is the retailer of fixtures, bad debt losses incurred in connection with the furnishing and installing of such fixtures are to be treated in the same manner as those resulting from other types of retail sales.</p> <p><u>A construction contractor who is a consumer of materials or fixtures, or both, under Sales and Use Tax Regulation 1521 cannot claim a bad debt deduction or refund with respect to such materials or fixtures. A United States construction contractor as defined in subdivision (a)(3) of Regulation 1521 is always the consumer of both materials and fixtures, and thus can never claim a bad debt deduction or refund with respect to such materials or fixtures. A construction contractor, other than a United States construction contractor, is generally the consumer of materials, and thus may claim a bad debt deduction with respect to materials only when the contractor is regarded as selling those materials under subdivision (b)(2)(A)2. of Regulation 1521. A construction contractor, other than a United States construction contractor, is the retailer of fixtures and thus may claim a bad debt deduction or refund with respect to its retail sales of such fixtures. A construction contractor incurring a bad debt loss for which it is entitled to a bad debt deduction or refund as just explained must claim the deduction or refund in the same manner as those resulting from other types of taxable retail sales of tangible personal property.</u></p>

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	<p>(3) ENTITY AFFILIATED WITH RETAILER. <u>The provisions of this subdivision (h)(3) apply only with respect to bad debt losses incurred on accounts created as a result of retail sales of tangible personal property for which the retailer remitted California sales or use tax on or after January 1, 2000.</u></p> <p><u>(A) If a retailer wishes to assign to a person who is its affiliated entity under section 1504 of Title 26 of the United States Code the right to claim a deduction or refund for the amount of bad debts for which the retailer is otherwise entitled to a deduction or refund, the retailer and the affiliated entity must file an election with the Board prior to the affiliated entity's claiming of any deduction or refund. This election filed with the Board must include all the following elements:</u></p> <ol style="list-style-type: none"> <u>1. The name, address, and seller's permit number of the retailer who reported or will report the tax; and the name, address, and seller's permit number of the affiliated entity of the retailer to whom the assignment is made.</u> <u>2. A statement clearly specifying that the affiliated entity is entitled to any (and all) deductions or refunds as a result of any bad debt losses charged off on the account(s) covered by the election and the effective date of that election, and a statement that the retailer relinquishes all claims to such deductions or refunds.</u> <u>3. A list of accounts to which the election pertains.</u> <u>4. The agreement of the retailer to furnish any and all documentation required by the Board to support the claiming of deductions or refunds by the affiliated entity.</u> <u>5. The acknowledgement by both the retailer and its affiliated entity that the Board may disclose relevant confidential information to all parties involved in order to support and confirm any deductions or refunds claimed.</u> <u>6. A statement that the election may not be amended or revoked unless a new election signed by both the retailer and its affiliated entity is filed with the Board.</u> <u>7. The acknowledgement by the affiliated entity that it cannot further assign the right to claim a deduction or refund for bad debts charged off on the account.</u> <u>8. The dated signatures of the retailer and its affiliated entity, or their authorized representatives. If a copy of the signed election is filed with the Board rather than the original, the affiliated entity must retain the election with the original signatures.</u> <p><u>(B) The term "retailer" as used in this regulation (except as used in subdivisions (h) and (i)) includes an entity affiliated with a retailer under section 1504 of Title 26 of the United States Code with respect to those accounts for which the affiliated entity is the person entitled to the bad debt deduction or claim pursuant to an election filed under this subdivision (h)(3).</u></p>

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	<p><u>(i) BAD DEBTS INCURRED IN CONNECTION WITH ACCOUNTS HELD BY LENDERS. The provisions of this subdivision (i) apply only with respect to bad debt losses incurred on accounts created as a result of retail sales of tangible personal property for which the retailer remitted California sales or use tax on or after January 1, 2000.</u></p> <p><u>(1) LENDER DEFINED.</u> A “lender” for purposes of this regulation is defined as any of the following:</p> <p><u>(A) A person who holds an account which that person purchased without recourse directly from a retailer who reported California sales or use tax with respect to the sales of tangible personal property for which credit was extended under the retail account.</u></p> <p><u>(B) A person who holds an account without recourse pursuant to that person’s contract directly with a retailer who reported California sales or use tax with respect to the sales of tangible personal property for which credit was extended under the retail account.</u></p> <p><u>(C) A person who is either an affiliated corporation (or affiliated entity electing to be taxed as a corporation) under section 1504 of Title 26 of the United States Code or an assignee of a person described in subdivision (i)(1)(A) or (i)(1)(B). A person is a “lender” under this subdivision (i)(1)(C) only if an election is filed under subdivision (i)(4).</u></p> <p><u>(2) CONDITIONS TO CLAIMING DEDUCTION OR REFUND.</u> With respect to an account held by a lender without recourse, a deduction or refund may be claimed for bad debt losses on the account only if all of the following conditions are met:</p> <p><u>(A) No deduction or refund was previously claimed or allowed on any portion of the account.</u></p> <p><u>(B) The account has been found worthless and charged off by the lender for income tax purposes (which include circumstances where the lender’s income is reported on a related person’s income tax return and the bad debt is charged off on that return) or, if the lender is not required to file income tax returns and the lender’s income is not reported on another person’s return, charged off in accordance with generally accepted accounting principles.</u></p> <p><u>(C) The contract between the retailer and the lender under which the lender has the right to the account contains an irrevocable relinquishment of all rights to the account from the retailer to the lender.</u></p> <p><u>(D) The account is for sales for which the retailer remitted California sales or use tax on or after January 1, 2000.</u></p> <p><u>(E) The retailer and the lender file an election with the Board which contains the elements specified in subdivision (i)(3) and which designates either the retailer or the lender as the person entitled to claim any deduction or refund under this regulation for tax previously paid by the retailer measured by amount of the account found to be worthless and charged off. No deduction or refund can be claimed until this election is filed with the Board.</u></p>

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	<p><u>(3) ELECTION BETWEEN RETAILER AND LENDER.</u></p> <p><u>(A) In order for the retailer or the lender to claim a deduction or refund for bad debt losses from an account held by the lender without recourse, the retailer and the lender must file an election with the Board designating which of them may claim such deduction or refund. The election may be in any form, including an existing contract between the retailer and the lender, so as long as the election contains the following elements:</u></p> <ol style="list-style-type: none"> <u>1. The name, address, and seller's permit number of the retailer who reported or will report the tax and the name, address, and seller's permit number, if any, of the lender to whom the account(s) is assigned.</u> <u>2. An agreement that the retailer relinquishes all rights to the account to the lender.</u> <u>3. A statement clearly specifying whether the retailer or the lender is entitled to claim any (and all) deductions or refunds as a result of any bad debt losses charged off by the lender for the account(s) covered by the election, the effective date of that election, and a statement that the other party relinquishes all rights to claiming such deductions or refunds.</u> <u>4. A list of accounts to which the election pertains. If the election is a blanket election for all accounts assigned without recourse by the retailer to the lender or all accounts held by the lender without recourse pursuant to the lender's contract directly with the retailer, the election must so state.</u> <u>5. The agreement of both the retailer and the lender to furnish any and all documentation requested by the Board to support the deductions or refunds claimed.</u> <u>6. The acknowledgement by both the retailer and the lender that the Board may disclose relevant confidential information to all parties involved in order to support and confirm any deductions or refunds claimed.</u> <u>7. If the lender is the person entitled to claim any deduction or refund for bad debts on the account, the Certificate of Registration – Lender account number of the lender. If the lender does not yet hold such a registration, the agreement of the lender that it will apply for the Certificate of Registration – Lender no later than on the date the lender first claims a deduction or refund for bad debts charged off on the account.</u> <u>8. A statement that the election may not be amended or revoked unless a new election signed by both the retailer and the lender is filed with the Board.</u> <u>9. The date of the election and the signatures of the retailer and the lender, or their authorized representatives. If a copy of the signed election is filed with the Board rather than the original, the person with the right under the election to claim the bad debt deduction or refund must retain the election with the original signatures. An election may be signed in</u>

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	<p><u>counterparts, and its filing would be regarded as perfected as of the filing of the second signed counterpart, provided each counterpart is identical except for the signature and date of the signature. If copies of the signed counterparts are filed with the Board, the person with the right under the election to the bad debt deduction or refund must retain all counterparts with the original signatures not filed with the Board.</u></p> <p><u>(B) The term “retailer” as used in this regulation (except as used in subdivisions (h) and (i)) includes a lender with respect to those accounts for which the lender is the person entitled to the bad debt deduction or claim pursuant to an election filed under this subdivision (i)(3).</u></p> <p><u>(4) ELECTION BETWEEN LENDER AND AFFILIATED ENTITY OR OTHER ASSIGNEE.</u></p> <p><u>(A) If a person who is a lender under subdivision (i)(1)(A) or (i)(1)(B) and who has the right to claim any deduction or refund for bad debts the lender charges off on the account wishes to assign to a person who is its affiliated entity under section 1504 of Title 26 of the United States Code or to some other assignee the right to claim any deduction or refund for the amount of bad debts charged off on the account, the lender and the affiliated entity or other assignee must file an election with the Board prior to the affiliated entity’s or other assignee’s claiming of any deduction or refund. The election filed with the Board may be in any form, but must include all the following elements:</u></p> <p><u>1. The name, address, and seller’s permit number of the retailer who reported or will report the tax; the name, address, seller’s permit number, if any, and Certificate of Registration – Lender account number, if any, of the lender under subdivision (i)(1)(A) or (i)(1)(B) making the assignment; and the name, address, seller’s permit number, if any, and Certificate of Registration – Lender account number, if any, of the person to whom the assignment is made under subdivision (i)(1)(C).</u></p> <p><u>2. A copy of the election between the retailer and the lender under which the lender has the right to any (and all) deductions or refunds as a result of any bad debt losses charged off by the lender on the account(s). If that election has not yet been filed with the Board, then that election must be filed along with the election between the lender and its affiliated entity or other assignee. If the election with the original signature was retained by the lender rather than filing it with the Board, that election must either be filed with the Board or retained by the affiliated entity or other assignee.</u></p> <p><u>3. A statement clearly specifying that the affiliated entity or other assignee is entitled to any (and all) deductions or refunds as a result of any bad debt losses charged off on the account(s) covered by the election and the effective date of that election, and a statement that the lender under subdivision (i)(1)(A) or (i)(1)(B) relinquishes all claims to such deductions or refunds.</u></p> <p><u>4. A list of accounts to which the election pertains. If the election is a blanket election for all accounts held by the lender, the election must so state.</u></p>

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	<p><u>5. The agreement of the lender to furnish any and all documentation required by the Board to support the claiming of deductions or refunds by the affiliated entity or other assignee.</u></p> <p><u>6. The acknowledgement by both the lender and its affiliated entity or other assignee that the Board may disclose relevant confidential information to all parties involved in order to support and confirm any deductions or refunds claimed.</u></p> <p><u>7. If the affiliated entity or other assignee does not yet hold a Certificate of Registration - Lender, the agreement that it will apply for that certificate no later than on the date it first claims a deduction or refund for bad debts charged off on the account.</u></p> <p><u>8. The acknowledgement by the affiliated entity or other assignee that it cannot further assign the right to claim a deduction or refund for bad debts charged off on the account.</u></p> <p><u>9. A statement that the election may not be amended or revoked unless a new election signed by both the lender and the affiliated entity or other assignee is filed with the Board.</u></p> <p><u>10. The date of the election and the signatures of the lender and the affiliated entity or other assignee, or their authorized representatives. If a copy of the signed election is filed with the Board rather than the original, the person with the right under the election to claim the bad debt deduction or refund must retain the election with the original signatures. An election may be signed in counterparts, and its filing would be regarded as perfected as of the filing of the second signed counterpart, provided each counterpart is identical except for the signature and date of the signature. If copies of the signed counterparts are filed with the Board, the person with the right under the election to the bad debt deduction or refund must retain all counterparts with the original signatures not filed with the Board.</u></p> <p><u>(B) The term “retailer” as used in this regulation (except as used in subdivisions (h) and (i)) includes an entity affiliated with a lender under section 1504 of Title 26 of the United States Code, or other assignee, with respect to those accounts for which the affiliated entity or other assignee is the person entitled to the bad debt deduction or claim pursuant to an election filed under this subdivision (i)(4).</u></p> <p><u>(5) REGISTRATION, RETURNS, CLAIMS FOR DEDUCTION AND REFUNDS, AND PAYMENT OF TAX.</u></p> <p><u>(A) A retailer who has the right to claim deductions or refunds for bad debts charged off by a lender on an account held by that lender pursuant to an election filed under subdivision (i)(3) shall claim those deductions or refunds under the provisions of this regulation in the same manner as if the retailer held the account itself.</u></p> <p><u>(B) Without regard to whether a lender holds a seller’s permit for its own sales of tangible personal property, a lender who has the right to claim deductions or refunds for bad debts charged off on accounts pursuant to an election filed under subdivision (i)(3) and, if applicable, subdivision (i)(4), shall register with the Board for a Certificate of Registration – Lender</u></p>

AGENDA — April 18, 2001 Business Taxes Committee Meeting
Proposed Regulatory Change Regarding Bad Debt Deductions for Tax Paid on
Transactions on Uncollectable Accounts Held By a Lender (Regulation 1642, Bad Debts)

Action Item	Regulatory Language Proposed by Staff
	<p><u>no later than the date on which it first claims such a deduction or refund. A lender applying for a Certificate of Registration – Lender shall provide such information as required by the Board.</u></p> <p><u>(C) A lender who has the right to claim deductions or refunds for bad debts charged off pursuant to an election filed under subdivision (i)(3) and, if applicable, subdivision (i)(4), is entitled to the same amount of deduction or refund, calculated in the same manner under the provisions of this regulation, as if the lender were the retailer who had sold the tangible personal property for which the retailer had reported and paid tax. If the lender has provided the name, address, and seller's permit number of the retailer responsible for paying the tax, in determining whether to grant the lender's claim for deduction or refund, the Board shall regard the retailer as having paid the applicable tax due unless the Board establishes otherwise. (Regardless of the Board's action on the lender's claim for deduction or refund, a retailer who failed to pay the applicable tax due remains liable for that tax.)</u></p> <p><u>(D) A lender who claims a deduction or refund for bad debts charged off shall be liable for tax on the taxable percentage of worthless accounts subsequently collected under subdivision (d), including amounts received for the sale of accounts for which the lender has claimed a bad debt deduction or refund.</u></p> <p><u>(E) A lender who has a seller's permit for its own sales of tangible personal property may not commingle the claiming of its deductions pursuant to an election under subdivision (i)(3) and, if applicable, subdivision (i)(4), with any bad debt deductions related to its own sales of tangible personal property but must instead report such deductions on a separate return or schedule in the form specified by the Board. If the lender files a schedule attached to its sales and use tax return, it may apply the amount of its deduction calculated on that separate schedule against its liability for sales and use tax. To the extent that the deduction is not fully exhausted when applied to the lender's own sales and use tax liability, the lender may file a claim for refund.</u></p> <p><u>(F) The filing by a lender of a claim for deduction or refund for bad debts on accounts covered by this subdivision (i) is not valid if an election pursuant to subdivision (i)(3) and, if applicable, an election pursuant to subdivision (i)(4), has not been filed with the Board. If a lender files a claim for deduction or refund and the applicable election(s) is filed thereafter, the claim for deduction or refund will be regarded as having been filed on the date of the filing of the election(s).</u></p> <p><u>(G) A lender holding a Certificate of Registration – Lender shall file a return in a form specified by the Board to report the taxable percentage of recoveries and claim losses on accounts covered by an election pursuant to subdivision (i)(3) and, if applicable, an election pursuant to subdivision (i)(4). This return shall be filed on a quarterly basis unless otherwise specified by the Board. The return shall include the taxable percentage of the amount of any recoveries for which the lender is liable for tax under subdivision (i)(5)(D). The lender may offset the amount of tax for which it would otherwise be entitled to a bad debt refund for the reporting period against the amount of tax for which it is liable for the taxable percentage of recoveries received during that same reporting period. The lender must file a return without regard to whether the lender received any net recoveries of previously claimed bad debts in the filing period. If the lender files a return under a seller's permit it holds for its own sales of tangible personal property, the lender must file a separate schedule to report the taxable</u></p>

AGENDA — April 18, 2001 Business Taxes Committee Meeting
Proposed Regulatory Change Regarding Bad Debt Deductions for Tax Paid on
Transactions on Uncollectable Accounts Held By a Lender (Regulation 1642, Bad Debts)

Action Item	Regulatory Language Proposed by Staff
	<p><u>percentage of its bad debt recoveries and losses on accounts covered by an election pursuant to subdivision (i)(3) and, if applicable, an election pursuant to subdivision (i)(4), in a form specified by the Board, as an attachment to the lender's sales and use tax return rather than filing a separate return for such recoveries and losses.</u></p> <p><u>(H) A lender claiming a deduction or refund for bad debts, or reporting tax on recoveries for accounts for which it previously claimed a bad debt deduction or refund, must properly allocate the local and district taxes. If the transactions were approved by the lender on a transaction-by-transaction basis or the lender has the necessary information to do so, local and district taxes should be allocated on an actual basis. The lender may allocate local and district taxes related to all other accounts on a pro-rata basis subject to approval by the Board which approval shall not be unreasonably withheld.</u></p>

AGENDA — April 18, 2001 Business Taxes Committee Meeting **Proposed Regulatory Change Regarding Bad Debt Deductions for Tax Paid on** **Transactions on Uncollectable Accounts Held By a Lender (Regulation 1642, Bad Debts)**

Regulatory Language Proposed by Staff

Appendix 1

EXAMPLE OF COMPUTING ALLOWABLE LOSS USING PRO RATA METHOD

I. Repossession Loss Per Records:

a. Rate.....	6%	
b. Sales price of car(*).....		\$9,000 (1)
c. (1) Sales tax.....		540
(2) License fees.....		160
(3) Insurance.....		300
d. Total cash selling price		\$10,000
e. Down payment.....		2,000 (2)
f. Cash sales balance.....		\$8,000
g. Finance charges.....		1,600
h. Contract balance.....		\$9,600
i. Payments on contract.....		1,900
j. Contract balance at date of repossession.....		\$7,700
m. Unearned finance charges.....	\$1,200	
n. Insurance rebate.....	100	1,300
"Net Payoff".....		\$6,400
o. Value of repossession.....		\$5,000
p. Repossession loss per records.....		<u>\$1,400</u>

II. Deductible Percentage of Loss:

a. Allocation of Down Payment:

Sales price of car.....		\$9,000
Total cash selling price.....		\$10,000
Less insurance rebate.....		100
Net Cash Price.....		<u>\$9,900 (3)</u>
	$\$9,000 (1) \times \$2,000 (2) =$	<u>\$1,818</u>
	\$9,900 (3)	

b. Unpaid Balance of Car:

Sales price of car		\$9,000
Less down payment.....		1,818
Unpaid balance of car.....		<u>\$7,182 (4)</u>
Contract balance.....		\$9,600
Less: Unearned finance.....	\$1,200	
Insurance rebate.....	100	1,300
Balance.....		<u>\$8,300 (5)</u>

AGENDA — April 18, 2001 Business Taxes Committee Meeting ***Proposed Regulatory Change Regarding Bad Debt Deductions for Tax Paid on*** ***Transactions on Uncollectable Accounts Held By a Lender (Regulation 1642, Bad Debts)***

Regulatory Language Proposed by Staff

~~— c. Deductible Percentage of Loss:~~
~~— \$7,182 (4) = 86.53% (taxable portion of loss)~~
~~— \$8,300 (5)~~

~~III. Allowable Deduction:~~
~~— \$1,400 x 86.53% = \$1,211 (allowable deduction)~~

~~NOTE: The letters 'k' and 'l' have been omitted from the example of computation of loss since they refer to information not used in this example.~~
~~(*)Includes miscellaneous charges such as "undersealing," "documentary fees," and "smog control certification."~~

AGENDA — April 18, 2001 Business Taxes Committee Meeting ***Proposed Regulatory Change Regarding Bad Debt Deductions for Tax Paid on Transactions on Uncollectable Accounts Held By a Lender (Regulation 1642, Bad Debts)***

Regulatory Language Proposed by Staff **Appendix 1**

EXAMPLE OF COMPUTING ALLOWABLE BAD DEBT DEDUCTION FOR A REPOSSESSED VEHICLE USING PRO RATA METHOD

Step One. Compute the Repossession Loss Per Records

a.	Retail sales price		\$12,000	
b.	Taxable fees (i.e., doc/smog)		<u>230</u>	
c.	Total amount subject to tax		12,230	(a+b)
d.	Sales Tax (6%)	734		(c*.06)
e.	License Fees	240		
f.	Other non-taxables	<u>0</u>		
g.	Total non-taxable charges		<u>974</u>	(d+e+f)
h.	<i>Total sales price</i>		13,204	(c+g)
i.	Down payment		<u>2,000</u>	
j.	Balance on contract		11,204	(h-i)
k.	Finance charges/accrued interest		<u>3,000</u>	
l.	Total contract value		14,204	(j+k)
m.	Payments received on contract		<u>2,100</u>	
n.	Balance on date of repossession		12,104	(l-m)
o.	Unearned finance charges		<u>2,750</u>	
p.	Net contract balance		9,354	(n-o)
q.	Value of repossession		<u>6,000</u>	
r.	Repossession loss per records		<u>\$3,354</u>	

Step Two. Compute the Taxable Percentage of Loss.

This is done by dividing the total amount subject to tax (line c) by the total sales price (line h).

$$12,230 / 13,204 = 92.62\%.$$

Step Three. Compute the Allowable Deduction.

This is done by multiplying the taxable percentage of loss (step Two) by the repossession loss per records (step One).

$$92.62\% * 3,354 = \underline{\$3,106.47}$$

AGENDA — April 18, 2001 Business Taxes Committee Meeting **Proposed Regulatory Change Regarding Bad Debt Deductions for Tax Paid on** **Transactions on Uncollectable Accounts Held By a Lender (Regulation 1642, Bad Debts)**

Regulatory Language Proposed by Staff

~~Appendix 2~~

~~CONSOLIDATION OF ALLOWABLE BAD DEBT DEDUCTION FOR REPOSSESSED MERCHANDISE USING PRO-RATA METHOD~~

(6% Sales)													
		(1)					(2)	(3)				(4)	(5)
						Net			Finance	Net			Less
Date of		Sales	Sales	License	Insurance	Cash	Down	Balance	Charges	Contract	Payment	Value	Repos-
Repos-		Price of	Tax	Fee	e	Sales	Payment	to	(Net)	Balance	s	of	session
Session	Car #	Mdse.	(6%)		(Net)	Price		Finance				Repos-	Loss Per
					(A)				(B)			session	Records
9-30-78	507	\$9,000	\$540	\$160	\$200	\$9,900	\$2,000	\$7,900	\$400	\$8,300	\$1,900	\$5,000	\$1,400
10-27-78	521	8,000	480	140	160	8,780	1,700	7,080	350	7,430	1,650	4,400	1,380
11-4-78	540	6,000	360	110	120	6,590	1,300	5,290	260	5,550	1,250	3,300	1,000
12-9-78	575	<u>5,000</u>	<u>300</u>	<u>90</u>	<u>100</u>	<u>5,490</u>	<u>1,100</u>	<u>4,390</u>	<u>200</u>	<u>4,590</u>	<u>1,000</u>	<u>2,700</u>	<u>890</u>
Totals		<u>\$28,000</u>	<u>\$1,680</u>	<u>\$500</u>	<u>\$580</u>	<u>\$30,760</u>	<u>\$6,100</u>	<u>\$24,660</u>	<u>\$1,210</u>	<u>\$25,870</u>	<u>\$5,800</u>	<u>\$15,400</u>	<u>\$4,670</u>

~~_____ Computation of allocation of down payment to merchandise.~~

$$\frac{\$28,000^{(1)}}{\$30,760^{(2)}} \times \$6,100^{(3)} = \$5,553$$

~~_____ Computation of allowable bad debt deduction:~~

$$\frac{\$28,000^{(1)} - \$5,553}{\$25,870^{(4)}} \times \$4,670^{(5)} = \$4,052$$

^(A) Original insurance charge less rebate of unearned premium.

^(B) Total finance charges per contract less unearned charges.

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Proposed Regulatory Change Regarding Bad Debt Deductions for Tax Paid on
Transactions on Uncollectable Accounts Held By a Lender (Regulation 1642, Bad Debts)

Regulatory Language Proposed by Staff

Appendix 2

**CONSOLIDATION OF ALLOWABLE BAD DEBT DEDUCTION FOR MULTIPLE
REPOSSESSED VEHICLES USING PRO RATA METHOD**

(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)	(J)	(K)	(L)	(M)	(N)
Date of Repos- session	Car #	Sales Price of Mdse ^A	Sales Tax (6%)	License Fee	Insurance (Net) ^B	Total Sales Price	Down Payment	Balance to Finance	Finance Charges (Net) ^C	Net Contract Balance	Payments	Value of Repos- session	Repos- session Loss Per Records
			[C*.06]			[C...F]		[G-H]		[I+J]			[K-L-M]
09-30-00	507	\$9,000	\$540	\$160	\$200	\$9,900	\$2,000	\$7,900	\$400	\$8,300	\$1,900	\$5,000	\$1,400
10-27-00	521	8,000	480	140	160	8,780	1,700	7,080	350	7,430	1,650	4,400	1,380
11-04-00	540	6,000	360	110	120	6,590	1,300	5,290	260	5,550	1,250	3,300	1,000
12-09-00	575	<u>5,000</u>	<u>300</u>	<u>90</u>	<u>100</u>	<u>5,490</u>	<u>1,100</u>	<u>4,390</u>	<u>200</u>	<u>4,590</u>	<u>1,000</u>	<u>2,700</u>	<u>890</u>
Totals		<u>\$28,000</u>	<u>\$1,680</u>	<u>\$500</u>	<u>\$580</u>	<u>\$30,760</u>	<u>\$6,100</u>	<u>\$24,660</u>	<u>\$1,210</u>	<u>\$25,870</u>	<u>\$5,800</u>	<u>\$15,400</u>	<u>\$4,670</u>
		(1)				(2)	(3)			(4)			(5)

<i>Computation of allocation of down payment to merchandise.</i>	<i>Computation of allowable bad debt deduction.</i>
$\frac{\$28,000^{(1)}}{\$30,760^{(2)}} \times \$6,100^{(3)} = \$5,553$	$\frac{\$28,000^{(1)} - \$5,553}{\$25,870^{(4)}} \times \$4,670^{(5)} = \$4,052$

^A Includes taxable amounts, such as doc and smog fees.

^B Original insurance charge less rebate of unearned premium.

^C Total finance charges per contract less unearned charges.

Issue Paper Number 01-006



- ☐ Board Meeting
- ☒ Business Taxes Committee
- ☐ Customer Services and Administrative Efficiency Committee
- ☐ Legislative Committee
- ☐ Property Tax Committee
- ☐ Other

PROPOSED REGULATORY CHANGES REGARDING BAD DEBT DEDUCTIONS REGULATION 1642, *BAD DEBTS*

I. Issue

Should Regulation 1642, *Bad Debts*, be amended to incorporate the statutory changes in Assembly Bill 599 (AB 599)?

II. Staff Recommendation

As agreed upon by staff and industry representatives, staff recommends adoption of the proposed revisions to Regulation 1642, *Bad Debts*, illustrated in Exhibit 2. The provisions of AB 599 are incorporated into subdivision 1642(h)(3) and new subdivision 1642(i). These proposed changes have an operative date of January 1, 2001, and apply to tax remitted on or after January 1, 2000, as required by statute.

In addition to the statutory provisions of AB 599, staff proposes a number of changes throughout the text of the regulation to clarify existing policies and to make minor technical changes to be consistent with current regulatory format. These changes are summarized on pages 3-4.

III. Other Alternative(s) Considered

Do not adopt proposed changes to Regulation 1642, *Bad Debts*.

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IV. Background

Revenue and Taxation Code (RTC) section 6051 imposes sales tax on retailers for the privilege of selling tangible personal property at retail within the state. RTC section 6201 imposes use tax for the storage, use, or other consumption in this state of tangible personal property purchased from any retailer in a transaction that was not subject to the sales tax. The sales tax is imposed on the retailer but is generally passed through to the consumer as sales tax reimbursement. (Civ. Code § 1656.1, Reg. 1700(a)(1).) The use tax is imposed on the consumer; however, any retailer engaged in business in this state is required to collect the use tax and remit it to the state. (RTC §§ 6202, 6203.)

Since 1957, the Sales and Use Tax Law has provided tax relief for retailers who hold accounts receivable that were included in the measure of tax and that become worthless prior to full payment of the account. These provisions are included in RTC sections 6055 and 6203.5, which provide that a retailer may take a deduction for that portion of the sales price of tangible personal property the retailer is unable to collect from the purchaser, provided the retailer previously remitted sales or use tax on such amounts. The right to take the deduction arose when the retailer wrote off the debt for income tax purposes. In 1970, sections 6055 and 6203.5 were amended to relieve a retailer from tax liability in cases where, although not required to file income tax returns, the retailer charged off worthless accounts in accordance with generally accepted accounting principles. (Stats. 1970, p. 1056.)

Regulation 1642, *Bad Debts*, was adopted by the Board in 1965 to explain and apply the bad debt provisions of the Sales and Use Tax Law. Regulation 1642 has been amended several times to provide further clarification and to incorporate statutory changes. Regulation 1642 was last amended in 1995 to clarify that if a deduction is not taken in the same period as that during which the debt was charged off, a claim for refund must be filed with the Board within the limitations period set forth in RTC section 6902.

In general, retailers selling tangible personal property on terms other than cash have several options with respect to the accounts receivable arising in the course of business. A retailer may retain an account receivable or may sell or otherwise dispose of it before it is fully collected. The sale of a debt (account receivable) is a financial arrangement between a retailer and another person (“lender”) separate from the original transaction creating the debt (i.e., the sale from the retailer to the customer). Accounts receivable can be sold with recourse or without recourse. “With recourse” means the seller of the debt (the retailer) will suffer any loss resulting from the inability to collect all amounts due. In essence, the retailer guarantees that the debt will be paid to the lender. “Without recourse” means that the lender will suffer any loss resulting from an uncollectible account. In essence, the lender accepts all the risks for collecting a debt acquired without recourse. Generally, retailers selling accounts with recourse receive a better price than when selling accounts without recourse because there is less risk to the lender.

AB 599 (Exhibit 3) amended RTC sections 6055 and 6203.5 to permit the taking of a bad debt deduction or claiming of a refund by either the retailer or the lender with respect to accounts sold without recourse, provided sales or use tax was reported and paid on the amount of the bad debt claimed. RTC section 6055(b)(3) defines the term “lender” to include: 1) any person who holds a retail account that the person purchased directly from a retailer who reported the tax; 2) any person who holds a retail account pursuant to that person’s contract directly with the retailer who reported the tax; and 3) any person who is an

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affiliated entity under section 1504 of Title 26 of the Internal Revenue Code of a person described in 1) or 2) or an assignee of a person described in 1) or 2).

As explained in Regulation 1642, a retailer who sells an account with recourse so that the retailer itself will bear any bad debt loss, is entitled to a bad debt deduction to the same extent as if the account had not been sold. However, prior to the adoption of AB 599, if the retailer sold an account without recourse, the retailer was not entitled to take a bad debt deduction, nor could anyone else, such as the lender who purchased the account without recourse. Similarly, there was no bad debt deduction allowed when a retailer used a “private label credit card.” Private label credit cards are credit cards through which a financing company extends credit to the customers of a retailer, with the name of the retailer shown on the face of the card. The financing company generally mails statements, collects payments, owns the receivables, and suffers any loss in the collection process. Prior to the amendments in AB 599, neither the retailer nor the financing company was entitled to claim a bad debt deduction for a worthless debt created through a private label credit card. Thus, there was a disparity in treatment between accounts retailers retained through collection or sold with recourse and accounts retailers sold without recourse or held under private label credit cards.

The provisions of AB 599 are effective January 1, 2001, and apply to accounts sold without recourse for which the tax was remitted on or after January 1, 2000. For such an account, the retailer and the lender must agree on whether the retailer or the lender is entitled to the bad debt deduction or refund and then file an election with the Board. As with other bad debt deductions, if a retailer or a lender obtains a tax benefit by deduction or refund for any amount it later collects, that person must report tax on the subsequently collected amounts.

V. Staff Recommendation

A. Description of the Staff Recommendation

Staff recommends the adoption of the proposed revisions to Regulation 1642, *Bad Debts*, illustrated in Exhibit 2. The provisions of AB 599 are incorporated into subdivision 1642(h) and new subdivision 1642(i). These proposed changes have an operative date of January 1, 2001, and apply to tax remitted on or after January 1, 2000, as required by statute.

Staff and industry also recommend the adoption of proposed revisions to the following subdivisions of Regulation 1642:

1. 1642(a). Proposed changes include changing the word “Section” to lowercase to be consistent with other regulations. In addition, language is proposed that would clarify that a retailer may claim a bad debt deduction in cases where a retailer’s income is reported on a related person’s income tax return.
2. 1642(b). Changes are proposed to provide that, in addition to the pro-rata and contract methods, an alternative method may be used to compute bad debts losses. While a change in the method in which bad debts losses are computed is not prohibited, bad debts that have been previously claimed may not be recomputed using another method.

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3. 1642(d). Staff and industry agree to language that provides that bad debt recoveries are to be reported on a pro-rata basis.
4. 1642(e). Proposed language requires that records must be maintained to support the percentage of bad debt loss allocable to taxable transactions and the applicable jurisdiction for local and district taxes.
5. 1642(f). Staff and industry agree to incorporate language that provides an alternative method of computing a bad debt loss and for establishing the wholesale value of repossessed merchandise.
6. 1642(g). Language has been proposed to provide that, if the contract between the retailer and customer is silent as to the method in which payments are applied, the accounting systems employed by the retailer may be used to compute the bad debt deduction.
7. 1642(h). The proposed revision to this subdivision provides language that further clarifies the application of bad debt deductions with respect to a “successor.” In addition, language has been added to clarify the application of tax with respect to construction contractors and entities affiliated with a retailer.

To incorporate the provisions of AB 599, the following issues have been addressed in staff’s proposed subdivision (i); on which industry agrees:

1. Registration of Lenders

When a lender purchases a retail account without recourse and the retailer and the lender file an election providing that the lender has the right to the sales and use tax benefits from bad debt losses on the account, the lender becomes responsible for reporting, and paying tax on any recoveries of amounts for which the lender obtained a bad debt sales and use tax benefit. Accordingly, it is necessary for such lenders to be registered to report such recoveries. Staff and industry recommend that all such lenders be required to register with the Board for a “Certificate of Registration – Lender,” whether or not the lender might also hold a seller’s permit for its own sales of tangible personal property. However, staff intends to identify lenders who are currently registered as retailers using their existing permit number. Although such lenders will be required to register for a “Certificate of Registration – Lender,” they will not need to obtain a separate permit number and file a separate return to report recovered bad debts.

2. Taking the Sales and Use Tax Benefit for Bad Debts and Filing of Returns

When a retailer and a lender elect for the retailer to take the sales and use tax benefits from bad debts on accounts the retailer sells to the lender without recourse, then the rules currently specified in Regulation 1642 will remain applicable to the retailer’s taking of such benefits. However, when the retailer and the lender elect for the lender to take such benefits, additional rules are required.

A lender obtaining a sales and use tax benefit pertaining to bad debts on purchased accounts will likely incur tax liabilities due to recoveries of previously claimed bad debts. A lender may also hold a seller’s permit and report and pay tax on its own sales of tangible personal property. Lenders will want to offset, to the extent possible, their benefit from bad debts on purchased accounts against their liability on recoveries and for their own retail sales of tangible personal property.

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However, bad debt deductions taken by a lender with respect to accounts purchased from a retailer must be segregated on the return from bad debts resulting from the lender's own retail sales. This is necessary, as bad debts derived from purchased accounts must be supported by an election. However, staff and industry believe that a lender should be able to offset bad debts incurred against other tax liabilities. Staff intends to design a schedule for use as an attachment to a lender's regular sales and use tax return for the lender to report its recoveries and to claim its bad debt benefits related to purchased accounts. Bad debts derived from retail sales will continue to be claimed directly on line ten of the sales and use tax return.

If there is a net benefit remaining after offsetting liabilities for recoveries and for taxable sales of tangible personal property, the new schedule will be designed such that the lender can sign it to act as a claim for refund with respect to the remaining benefit. The same schedule, with perhaps slight modification, will also be used as the return/claim for refund for those lenders who do not hold a seller's permit for their own sales of tangible personal property. Lenders will be required to file such returns to report their recoveries on a quarterly basis, unless otherwise required by the Board.

3. Required Elements for a Valid Election

AB 599 requires that when a retailer sells an account without recourse, prior to the claiming of any sales and use tax benefit for bad debts from the account, the retailer and the lender must file an election specifying which person has the right to take those benefits. Staff and industry propose that such an election be considered valid if it contains all of the following elements:

- The name, address, and seller's permit number of the retailer who reported or will report the tax and the lender to whom the account(s) is (are) assigned.
- An agreement that the retailer relinquishes all rights to the account to the lender.
- A statement clearly specifying whether the person entitled to any (and all) deductions or refunds as a result of any bad debt losses on the account(s) covered by the election is the retailer or the lender.
- A list of accounts to which the election pertains. If the election is a blanket election intended to cover all accounts assigned by the retailer to the lender, the election must so state.
- The agreement of both the retailer and the lender to furnish any and all documentation requested by the Board to support the deductions or refunds claimed.
- An acknowledgement by the retailer and the lender that the Board may disclose relevant confidential information to all parties involved supporting and confirming any deductions or refunds claimed.
- A statement that the election may not be amended or revoked unless a new election is signed by both the retailer and the lender and filed with the Board.
- The signatures of persons authorized to act on behalf of the parties entering into the election agreement.

FORMAL ISSUE PAPERIssue Paper Number 01-006**4. Records**

Lenders claiming benefits under AB 599 will be required to provide the Board with all the records required by subdivision (e) of Regulation 1642 as well as information supporting the proper allocation of local and district taxes. In addition, the lender will be required to provide documentation to support any alternative method used to claim a bad debt deduction or claim for refund.

5. Assignments

Under AB 599, the term “lender” includes all of the following:

- Any person who holds a retail account which that person purchased directly from a retailer who reported the tax.
- Any person who holds a retail account pursuant to that person’s contract directly with the retailer who reported the tax.
- Any person who is an affiliated entity (under Section 1504 of Title 26 of the United States Code) or an assignee of a person described in subdivision (h)(1)(A).

The third definition includes certain affiliated entities or assignees of a person defined as a lender in the first or second definition. Only one person can be entitled to take the sales and use tax benefit for bad debt losses incurred with respect to any account. Thus, if a lender with the right to the bad debt benefits thereafter assigns the account to an affiliate or other person, only the lender or the assignee can have the right to the sales and use tax benefits for bad debts from that account. If the lender and the assignee agree that the assignee will acquire those benefits, an election must be filed with the Board specifying that such is the case. That election must include a copy of the relevant election filed with the Board which was executed by the retailer and the lender, and must include the same information for the lender and the assignee as required in an election filed by a retailer and a lender. Upon the filing of such an election to transfer the rights to an affiliate or other assignee, that affiliate or assignee is a lender for purposes of the assigned account and subject to all the requirements of a lender, including the registration and reporting requirements. Staff and industry agree that AB 599 does not permit an assignee from a lender (as defined in the first two definitions) to further assign the sales and use tax bad debt benefits.

6. Sales at Discount

A person who holds an account may sell that account at a discount. The amount of the discount is not a bad debt. For example, a retailer with an account receivable of \$10,000 who sells it to a lender for \$9,500 cannot take a bad debt deduction of \$500. If the retailer sells that account without recourse, the parties may file an election transferring the right to the bad debt benefits to the lender. If the lender thereafter writes off the entire \$10,000 due under the account, based on the wording of AB 599, the lender has the right to bad debt benefits measured by that full \$10,000, not just the \$9,500 purchase price.

A retailer or a lender who has acquired the bad debt benefits for a retail account may write off the account and thereafter sell that account to another person. Persons who purchase such accounts

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usually pay very little for the account because of the minimal possibility of further collections. These sales of accounts are of a completely different character than the sale of an account for a discount when both the seller and the purchaser anticipate full collection on the account, such as the example in the previous paragraph. That is, the retailer or lender sells the account for pennies on the dollar because the retailer or lender continues to consider the account worthless and uncollectible. Sales of worthless accounts do not affect the retailer's or lender's right to the bad debt benefits; however, the amounts paid to retailers or lenders for these accounts are recoveries for purposes of subdivision (d) of Regulation 1642. The retailer or lender must include all recoveries on the first return filed after receiving payments and report and remit tax accordingly.

7. Presumption that the Retailer Remitted the Tax

Staff and industry agree that if the retailer did not remit the tax to the State, the refund or deduction must be disallowed for that account. However, staff and industry agree that if a lender provides the name and address of the retailer, a presumption should arise that the retailer remitted the tax on the sales.

8. Allocation of Local Taxes

With respect to accounts purchased from a retailer, if the transactions were approved by the lender on a transaction-by-transaction basis or the lender has the necessary information to do so, local and district taxes should be allocated on the schedule on an actual basis. Local and district taxes related to all other accounts may be allocated on a pro-rata basis subject to approval by the Board.

9. Credit Card Companies

Staff and industry agree that private label credit cards were intended to benefit from the provisions of AB 599. While staff and industry do not believe that credit card companies which enter into a contract with a consumer to provide a revolving credit account that may be used at any business establishment accepting such credit were intended to benefit from the bad debt provisions of AB 599, such companies are not statutorily excluded. Accordingly, staff and industry agree that the companies may qualify under AB 599 as long as they are able to segregate taxable and non-taxable transactions, meet all of the required criteria, and file an election in proper form with the Board.

10. WFS Financial

In the matter of WFS Financial, Inc., involving a claim for refund for bad debts on defaults that lenders purchased without recourse from vehicle dealers, the Board issued a memorandum opinion on December 14, 2000, interpreting Revenue and Taxation Code section 6055 and Regulation 1642, specifying that these lenders to motor vehicle dealers may obtain a bad debt deduction or refund under the following circumstances:

1. Claimant's representatives were either present on the dealers' premises or immediately available by telephone, facsimile, or computer connection at the time the vehicles in question were sold;
2. Claimant paid full consideration to the dealers for the receivables in question, i.e., claimant did not purchase the receivables at a discount; and

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3. The dealers' assignments to claimant of the receivables in question were substantially contemporaneous with the execution of the sales agreements between the dealers and the purchasers.

As discussed herein, Revenue and Taxation Code sections 6055 and 6302.5 were amended by AB 599 to set forth the requirements for all lenders, including lenders to motor vehicle dealers, to claim bad debt deductions or refunds with respect to specified transactions for which the retailers remitted California sales or use tax on or after January 1, 2000. Accordingly, staff will be instructed to continue applying the WFS Financial, Inc. memorandum decision with respect to claims by WFS Financial and similarly situated lenders for transactions where the retailers remitted California sales or use tax prior to January 1, 2000. However, the amendments to Revenue and Taxation Code sections 6055 and 6302.5 obviate the need for lenders like WFS Financial to look to the memorandum of opinion decision for purposes of claiming bad debt deductions with respect to tax remitted on and after January 1, 2000. Accordingly, the provision of Revenue and Taxation Code section 6055 and 6302.5 and Regulation 1642, as amended, and not the memorandum of opinion, apply to the transactions of WFS Financial and similarly situated lenders with respect to tax remitted on or after January 1, 2000.

Furthermore, subdivision (h)(1)(A) of Regulation 1642 has been rewritten to clarify that the term "successor" for the purposes of Regulation 1642 means a person required to withhold an amount up to the purchase price of the business to cover the seller's sales or use tax liability, if any, and that, if the successor may claim the bad debt deduction, the predecessor may not.

B. Pros of the Staff Recommendation

- Implements statutory changes as required by AB 599.
- Provides a system of administering bad debt benefits claimed by the retailer or lender.

C. Cons of the Staff Recommendation

Requires regulatory change.

D. Statutory or Regulatory Change

The 2000 Legislative Session created the new statute that requires amendments to Regulation 1642.

E. Administrative Impact

Staff will need to develop a new schedule to add to the return of accounts identified as lenders and establish a system of filing elections. Staff will notify taxpayers through a Tax Information Bulletin article.

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F. Fiscal Impact

1. Cost Impact

Once the amendments are approved by the Office of Administrative Law, a special notice will be mailed to approximately 5,000 affected lenders who are not registered with the Board. The special notice will consist of a one page, front to back, letter with the taxpayer's mailing address displayed through a window envelope. The estimated cost of each special notice is as follows:

Labor: No additional costs since this is considered within the routine workload of the Policy Development Section (SUTD Program Planning Division), Customer and Taxpayer Services Division, Legal Division, Board Proceedings Division and Mail Services Unit (Administrative Division).

Printing:

5,000 pages front to back @ .01 per page = \$50.00

Envelopes:

5,000 E-18 window envelopes @ .02 per envelope = 100.00

Postage:

5,000 @ .17 bulk presorted = 850.00

Total Estimated Cost for Special Notice Mailing \$1,000.00

The costs associated with the distribution of Tax Information Bulletins, which are routinely prepared and distributed to taxpayers, are accommodated within the Board's existing budget.

2. Revenue Impact

None. See Revenue Estimate (Exhibit 1).

G. Taxpayer/Customer Impact

As required by statute, the proposed amendments require the filing of elections with the Board. A new schedule has been proposed to expedite the processing and administration of bad debt deductions and claims for refund.

H. Critical Time Frames

The proposed changes related to AB599 apply to tax remitted on or after January 1, 2000, and have an operative date of January 1, 2001, as required by statute. Other changes have no operative date.

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VI. Alternative 1

A. Description of the Alternative

Make no changes to Regulation 1642, *Bad Debts*.

B. Pros of the Alternative

Requires no regulatory change.

C. Cons of the Alternative

- Does not implement statutory changes as required by AB 599.
- Does not provide a system of administering bad debt benefits claimed by the retailer or lender.

D. Statutory or Regulatory Change

None.

E. Administrative Impact

None.

F. Fiscal Impact

1. Cost Impact

None.

2. Revenue Impact

None. See Revenue Estimate (Exhibit 1).

G. Taxpayer/Customer Impact

None.

H. Critical Time Frames

None.

Prepared by: Program Planning Division, Sales and Use Tax Department

Current as of: 04/06/2001

REVENUE ESTIMATE

STATE OF CALIFORNIA
BOARD OF EQUALIZATION



PROPOSED REGULATORY CHANGES
REGARDING BAD DEBT DEDUCTIONS
REGULATION 1642, *BAD DEBTS*

Staff Recommendation

As agreed upon by staff and industry representatives, staff recommends adoption of the proposed revisions to Regulation 1642, *Bad Debts*, illustrated in Exhibit 2. The provisions of AB 599 are incorporated into subdivision 1642(h)(3) and new subdivision 1642(i). These proposed changes have an operative date of January 1, 2001, and apply to tax remitted on or after January 1, 2000, as required by statute.

In addition to the statutory provisions of AB 599, staff proposes a number of changes throughout the text of the regulation to clarify existing policies and to make minor technical changes to be consistent with current regulatory format. These changes are summarized on pages 3-4.

Alternative 1

Do not adopt proposed changes to Regulation 1642, *Bad Debts*.

Background, Methodology, and Assumptions

Staff Recommendation:

While there is a revenue loss associated with the implementation of AB 599, the proposed amendments to Regulation 1642 do not themselves impact revenues, since the proposed amendments are consistent with statutory changes brought about by AB 599.

Alternative 1:

Alternative 1 has no revenue effect.

Revenue Summary

The staff recommendation has no revenue effect.

The alternative proposal has no revenue effect.

Preparation

This revenue estimate was prepared by David E. Hayes, Research and Statistics Section, Agency Planning and Research Division. This revenue estimate was reviewed by Ms. Laurie Frost, Chief, Agency Planning and Research Division and Ms. Charlotte Paliani, Program Planning Manager, Sales and Use Tax Department. For additional information, please contact Mr. Hayes at (916) 445-0840.

Current as of March 28, 2001

Regulation 1642. Bad Debts.

Reference: Sections 6055, ~~and~~ 6203.5, and 6451, Revenue and Taxation Code.

(a) IN GENERAL. A retailer is relieved from liability for sales tax (Section 6055 of the Revenue and Taxation Code) or from liability to collect use tax (Section 6203.5 of the Revenue and Taxation Code) insofar as the measure of the tax is represented by accounts found worthless and charged off for income tax purposes (which include circumstances where the retailer's income is reported on a related person's income tax return and the bad debt is charged off on that return) or, if the retailer is not required to file income tax returns and the retailer's income is not reported on another person's return, charged off in accordance with generally accepted accounting principles. A retailer may claim a bad debt deduction provided that the sales tax, or amount of use tax, was actually paid to the state.

This deduction should be taken on the return filed for the period in which the amount was found worthless and charged off for income tax purposes or, if the retailer is not required to file income tax returns, charged off in accordance with generally accepted accounting principles.

Failure to take the deduction on the proper return will not in itself prevent the allowance of a refund measured by an amount for which a retailer could have taken a timely deduction provided a claim for refund is filed with the board within the limitation periods specified in Section 6902 of the Revenue and Taxation Code.

(b) AMOUNT SUBJECT TO DEDUCTION.

(1) ~~NONTAXABLE RECEIPTS.~~ If the amount of an account found to be worthless and charged off is comprised in part of nontaxable receipts such as interest, insurance, repair, or installation labor ~~and other charges exempt from sales or use tax~~ and in part of taxable receipts upon which tax has been paid, a bad debt deduction may be claimed only with respect to the unpaid amount upon which tax has been paid. In determining that amount, all payments and credits to the account may be applied ratably against the various elements comprising the amount the purchaser contracted to pay (pro rata method), ~~or~~ may be applied as provided in the contract of sale (contract method), or may be applied by another method which reasonably determines the amount of the taxable receipts (alternative method). When claiming a bad debt deduction or refund using an alternative method, the retailer must include a clear explanation of that method along with the claiming of the deduction or refund. After having applied payments and credits ~~by either the pro rata method or the contract method, and having filed returns based on such application of payments and credits using one method and claiming a deduction or refund based on such method,~~ a retailer shall not thereafter reapply the payments or credits ~~by the using another method with respect to such losses previously claimed.~~ so as to claim additional bad debts by way of deduction, credit or refund.

(2) EXPENSES OF COLLECTION. No deduction is allowable for expenses incurred by the retailer in attempting to enforce collection of any account receivable, or for that portion of a debt recovered that is retained by or paid to a third party as compensation for services rendered in collecting the account.

(c) REPORTING. All retailers must report sales tax liability on an accrual basis. Bad debt deductions will not be disallowed ~~retailers solely for the reason that they are a retailer~~ is on a cash reporting basis for income tax purposes.

Regulation 1642. Bad Debts.

(d) WORTHLESS ACCOUNTS SUBSEQUENTLY COLLECTED. If any accounts found worthless and charged off ~~are~~ is thereafter ~~in whole or in part~~ collected by the retailer, in whole or in part, the taxable percentage of the amount so collected shall be included in the first return filed after such collection and tax shall be paid on such ~~the amount of the tax thereon paid~~ with the return. The same percentage of the account which the retailer claimed as an allowable bad debt deduction or refund shall be used to determine the taxable percentage of the recovery. The taxable percentage of any amounts received from a third party for the sale of an account after the retailer has found them to be worthless and has claimed a bad debt deduction or refund are regarded as amounts subsequently collected for purposes of this provision, and the retailer must include such amounts in the first return filed after receipt of such amounts and pay tax thereon.

(e) RECORDS. In support of deductions or claims for ~~credit refund~~ for bad debts, retailers must maintain adequate and complete records showing:

- (1) Date of original sale.
- (2) Name and address of purchaser.
- (3) Amount purchaser contracted to pay.
- (4) Amount on which retailer paid tax.
- (5) The jurisdiction(s) where the local taxes and, when applicable, district taxes were allocated.
- (6) All payments or other credits applied to account of purchaser.
- (67) Evidence that the uncollectible portion of gross receipts on which tax was paid actually has been legally charged off as a bad debt for income tax purposes (whether or not the income tax return has yet been filed) or, if the retailer is not required to file income tax returns and the retailer's income is not reported on another person's return, charged off in accordance with generally accepted accounting principles.
- (8) The taxable percentage of the amount charged off as a bad debt properly allocable to the amount on which the retailer reported and paid tax. (See Appendix 1.)

(f) REPOSSESSIONS. ALLOWABLE METHODS OF COMPUTING LOSS.

(1) IN GENERAL. When there is a repossession, a bad debt deduction is allowable only to the extent that the retailer sustains a net loss of gross receipts upon which tax has been paid. This will be when the amount of all payments and credits allocated to the purchase price of the merchandise, including the wholesale value of the repossessed article, is less than that price. ~~Depending on whether~~ If the pro rata method or the contract method is used to apply payments, a retailer incurs an allowable bad debt deduction if the wholesale value of the repossessed merchandise is less than the net contract balance (after excluding unearned insurance and finance charges) at the date of repossession. ~~or (2) if~~ If the contract method is used to apply payments, a retailer incurs an allowable bad debt deduction if the wholesale value of the repossessed merchandise is less than the net merchandise contract balance at the date of repossession. An alternative method of computing a bad debt loss may be used subject to approval by the Board which approval shall not be unreasonably withheld.

~~(2) COMPUTING LOSS ON REPOSSESSION INFORMATION REQUIRED.~~ The amount of net loss will be computed by deducting from the original sales price upon which tax has been paid, the amount of all payments, trade-in allowances or other credits applicable

Regulation 1642. Bad Debts.

to such sales price, under the pro rata method or contract method, plus the amount for which a retailer, at the time of repossession, could acquire a similar article from a wholesaler.

In order to compute an allowable deduction for repossessed merchandise, the following information is necessary:

- (A) Date of sale.
- (B) Cash sales price of the merchandise sold.
- (C) Amount of charges for intangibles included in the cash sales price:
 - 1. Sales tax reimbursement.
 - 2. License fees, if a vehicle.
 - 3. Installation labor, etc., for a fixture, furniture or heavy appliance.
 - 4. Insurance.
 - 5. Any other nontaxable charges except finance charges.
- (D) Total cash sales price.
- (E) Amount of down payment.
- (F) Amount of cash sales balance.
- (G) Finance charges.
- (H) Contract balance.
- (I) Payments on contract.
- (J) Contract balance at date of repossession.
- (K) Date of repossession.
- (L) Date of payoff.
- (M) Unearned finance charges.
- (N) Amount of insurance rebate.
- (O) Wholesale value of repossessed merchandise.
- (P) Repossession loss per records.

(32) Method of Computing Loss—Pro Rata Method. METHOD OF COMPUTING LOSS - PRO RATA METHOD.

(A) **LOSS PER RECORDS.** This is the net payoff less the wholesale value of the repossessed merchandise. The net payoff is the contract balance at the date of repossession less unearned finance charges and insurance rebates. The loss per records is the bad debt loss the retailer writes off for income tax purposes. An estimate of bad debt losses based in part upon the history of the business or industry averages, may not be used to claim bad debt deductions or refunds for sales and use tax purposes.

(B) **TAXABLE PORTION OF LOSS PER RECORDS** Taxable Portion of Loss Per Records. This is computed in two steps:

- 1. Allocation of down payment to merchandise. Sales price of merchandise divided by total cash selling price (includes all intangibles other than finance charges) less the insurance rebate multiplied by the down payment.
- 2. Taxable portion of loss per records. The unpaid balance of merchandise cost (sales price less down payment allocation per (1) above) divided by the contract balance less unearned finance charges and insurance rebates.

Regulation 1642. Bad Debts.

The repossession loss per records as computed in (A) above, multiplied by the taxable portion of the loss, as computed in (B)2. above, results in the allowable bad debt deduction. (See Appendix 1 at end of regulation for example.)

Only that portion of a bad debt loss attributable to the amount on which the retailer paid tax may be used to claim a bad debt deduction or refund for sales and use tax purposes. Even an account with all sales subject to tax may include some amounts on which tax was not paid, such as the tax or tax reimbursement charged to the consumer which is included in the account balance. The percentage of loss on which tax was paid for an account which is secured by the merchandise purchased, or which represents a single purchase of a significant amount, should be calculated on an actual basis. The percentage of loss on which tax was paid for accounts involving a large volume of small transactions may be calculated based on an analysis of the composition of the accounts receivable. All accounts of the retailer for which this calculation is made should use the same method of applying payments for the calculation (e.g., use FIFO for all accounts or use LIFO for all accounts). Examples using the pro rata method are attached as Appendices 1 and 2.

(43) METHOD OF COMPUTING LOSS--CONTRACT METHOD. The allowable bad debt deduction is the net merchandise balance after payments and credits have been applied as provided by the contract, less the wholesale value of the repossessed merchandise, calculated by subtracting all payments and credits from the purchase price of the merchandise pursuant to the method of applying payments set forth in the applicable contract(s) with the customer and, to the extent the contract is silent on the method of applying payments, the loan accounting systems used by the retailer in the ordinary course of business, and from that amount subtracting the proceeds of the sale of any repossessed merchandise in accordance with (4) below.

(54) DETERMINING THE WHOLESALE VALUE OF REPOSSESSED MERCHANDISE. One of the prerequisites in computing the loss on repossessed merchandise is determining the wholesale value thereof. The wholesale value of repossessed merchandise must be determined in order to calculate the allowable bad debt deduction, if any, for the account. When the retailer sells the repossessed merchandise to a reseller in an arm's length transaction, the amount the retailer receives for the sale, less the direct cost of reconditioning the property prior to that sale and direct auction expenses paid to a third party, is the wholesale value. Otherwise, other sources must be used to determine the wholesale value. In the case of automobiles, information contained in industry-recognized wholesale and retail price guides will be acceptable are generally the best source of such information. Adjustments may should be made to the published wholesale prices in those instances where the automobile is in other than average condition.

Establishing the wholesale value ~~on~~ of other types of repossessed merchandise, such as jewelry, furniture, appliances, etc., presents a more difficult problem if the retailer does not sell the merchandise to a reseller in an arm's length transaction. Each case must be considered on its own merits. Generally, if the retailer places the repossessed property into resale inventory, the retailer should will be able to use the amount at which the merchandise is brought back into recorded in resale inventory as its wholesale value. This amount should not, however, include any costs of repossessing, reconditioning, or other expense to put the merchandise in saleable condition.

Regulation 1642. Bad Debts.

(65) CONSOLIDATION OF NUMEROUS REPOSSESSED ITEMS. Retailers who have several repossessions each reporting period will find it convenient and time saving to consolidate the pertinent data. When this is done, only one calculation for each set of transactions need be made to compute the allowable deduction. The consolidations may be made by using 15-column working paper with one column for each of the elements required to compute the deduction (see Appendix 2).

Only those repossessions on which a loss is incurred should be scheduled. The ~~taxpayer~~ retailer may quickly determine whether a particular transaction should be scheduled by comparing the net payoff with the wholesale value of the merchandise. If the net payoff is greater, a loss has been suffered and the transaction should be scheduled.

~~(7) NET MERCHANDISE BALANCE. The term "net merchandise balance" as used herein means the amount remaining after all payments and credits have been deducted from the purchase price of the merchandise.~~

(g) **BAD DEBT LOSSES OTHER THAN REPOSSESSIONS.** Allowable bad debt deductions or refunds also may arise from sales made on an open account or on an unsecured installment ~~bases~~ basis. ~~These~~ The deduction or refund should be computed in substantially the same manner as those involving repossessions, (i.e., by prorating all payments or credits between the cash sales price of the merchandise on which the retailer paid tax and the intangible nontaxable charges or by applying all payments and credits as provided in the contract of sale and, if the contract is silent, the loan accounting systems used by the retailer in the ordinary course of business). No deduction or claim for refund or credit will be allowed in any period subsequent to the period in which a bad debt deduction is taken, based on a method of calculating the bad debt deduction different from that originally used in calculating the bad debt deduction.

(h) SPECIAL SITUATIONS.**(1) BAD DEBT DEDUCTIONS TO FOR PERSONS OTHER THAN THE RETAILER OR LENDER.**

(A) A successor who pays full consideration for receivables acquired from the predecessor is entitled to a bad debt deduction to the same extent that the predecessor would have been entitled had the predecessor continued the business. A "successor" for purposes of this provision is one who is required by Revenue and Taxation Code section 6811 to withhold sufficient of the purchase price of the subject business to cover amounts due from the seller of the business under the Sales and Use Tax Law. A predecessor may not claim a bad debt deduction for any transaction or account for which a successor is entitled to a bad debt deduction under this provision.

(B) ~~A~~ Except as provided in subdivision (h)(1)(A) and subdivision (i), a purchaser of receivables, other than a successor, cannot obtain claim a bad debt deduction on or refund for accounts which are not collected.

(C) A retailer who sells receivables with recourse so that the retailer will bear any bad debt loss on them is entitled to a bad debt deduction to the same extent as if the receivables had not been sold. The fact that a retailer sells receivables at a discount, however, with or without

Regulation 1642. Bad Debts.

recourse, does not in itself entitle the retailer to a bad debt deduction to the extent of the discount.

(2) BAD DEBTS OF CONSTRUCTION CONTRACTORS. ~~Subparagraph (b)(2)(A)2. of Section 1521 of Title 18 recognizes two instances when a contractor (other than a United States construction contractor as defined in section (b)(1)(A) of Section 1521 of Title 18) is considered to be selling materials prior to installation. In those two instances only, when the contractor reports and pays tax on the sales price of the materials and the receivable is thereafter found to be worthless and is charged off for income tax purposes, a bad debt deduction may be taken by the contractor.~~

~~Since a contractor (other than a United States construction contractor as defined in section (b)(1)(A) of Section 1521 of Title 18 is the retailer of fixtures, bad debt losses incurred in connection with the furnishing and installing of such fixtures are to be treated in the same manner as those resulting from other types of retail sales.~~

A construction contractor who is a consumer of materials or fixtures, or both, under Sales and Use Tax Regulation 1521 cannot claim a bad debt deduction or refund with respect to such materials or fixtures. A United States construction contractor as defined in subdivision (a)(3) of Regulation 1521 is always the consumer of both materials and fixtures, and thus can never claim a bad debt deduction or refund with respect to such materials or fixtures. A construction contractor, other than a United States construction contractor, is generally the consumer of materials, and thus may claim a bad debt deduction with respect to materials only when the contractor is regarded as selling those materials under subdivision (b)(2)(A)2. of Regulation 1521. A construction contractor, other than a United States construction contractor, is the retailer of fixtures and thus may claim a bad debt deduction or refund with respect to its retail sales of such fixtures. A construction contractor incurring a bad debt loss for which it is entitled to a bad debt deduction or refund as just explained must claim the deduction or refund in the same manner as those resulting from other types of taxable retail sales of tangible personal property.

(3) ENTITY AFFILIATED WITH RETAILER. The provisions of this subdivision (h)(3) apply only with respect to bad debt losses incurred on accounts created as a result of retail sales of tangible personal property for which the retailer remitted California sales or use tax on or after January 1, 2000.

(A) If a retailer wishes to assign to a person who is its affiliated entity under section 1504 of Title 26 of the United States Code the right to claim a deduction or refund for the amount of bad debts for which the retailer is otherwise entitled to a deduction or refund, the retailer and the affiliated entity must file an election with the Board prior to the affiliated entity's claiming of any deduction or refund. This election filed with the Board must include all the following elements:

1. The name, address, and seller's permit number of the retailer who reported or will report the tax; and the name, address, and seller's permit number of the affiliated entity of the retailer to whom the assignment is made.

2. A statement clearly specifying that the affiliated entity is entitled to any (and all) deductions or refunds as a result of any bad debt losses charged off on the account(s) covered

Regulation 1642. Bad Debts.

by the election and the effective date of that election, and a statement that the retailer relinquishes all claims to such deductions or refunds.

3. A list of accounts to which the election pertains.
 4. The agreement of the retailer to furnish any and all documentation required by the Board to support the claiming of deductions or refunds by the affiliated entity.
 5. The acknowledgement by both the retailer and its affiliated entity that the Board may disclose relevant confidential information to all parties involved in order to support and confirm any deductions or refunds claimed.
 6. A statement that the election may not be amended or revoked unless a new election signed by both the retailer and its affiliated entity is filed with the Board.
 7. The acknowledgement by the affiliated entity that it cannot further assign the right to claim a deduction or refund for bad debts charged off on the account.
 8. The dated signatures of the retailer and its affiliated entity, or their authorized representatives. If a copy of the signed election is filed with the Board rather than the original, the affiliated entity must retain the election with the original signatures.
- (B) The term "retailer" as used in this regulation (except as used in subdivisions (h) and (i)) includes an entity affiliated with a retailer under section 1504 of Title 26 of the United States Code with respect to those accounts for which the affiliated entity is the person entitled to the bad debt deduction or claim pursuant to an election filed under this subdivision (h)(3).
- (i) BAD DEBTS INCURRED IN CONNECTION WITH ACCOUNTS HELD BY LENDERS.** The provisions of this subdivision (i) apply only with respect to bad debt losses incurred on accounts created as a result of retail sales of tangible personal property for which the retailer remitted California sales or use tax on or after January 1, 2000.
- (1) LENDER DEFINED. A "lender" for purposes of this regulation is defined as any of the following:
- (A) A person who holds an account which that person purchased without recourse directly from a retailer who reported California sales or use tax with respect to the sales of tangible personal property for which credit was extended under the retail account.
 - (B) A person who holds an account without recourse pursuant to that person's contract directly with a retailer who reported California sales or use tax with respect to the sales of tangible personal property for which credit was extended under the retail account.
 - (C) A person who is either an affiliated corporation (or affiliated entity electing to be taxed as a corporation) under section 1504 of Title 26 of the United States Code or an assignee of a person described in subdivision (i)(1)(A) or (i)(1)(B). A person is a "lender" under this subdivision (i)(1)(C) only if an election is filed under subdivision (i)(4).

(2) CONDITIONS TO CLAIMING DEDUCTION OR REFUND. With respect to an account held by a lender without recourse, a deduction or refund may be claimed for bad debt losses on the account only if all of the following conditions are met:

Regulation 1642. Bad Debts.

(A) No deduction or refund was previously claimed or allowed on any portion of the account.

(B) The account has been found worthless and charged off by the lender for income tax purposes (which include circumstances where the lender's income is reported on a related person's income tax return and the bad debt is charged off on that return) or, if the lender is not required to file income tax returns and the lender's income is not reported on another person's return, charged off in accordance with generally accepted accounting principles.

(C) The contract between the retailer and the lender under which the lender has the right to the account contains an irrevocable relinquishment of all rights to the account from the retailer to the lender.

(D) The account is for sales for which the retailer remitted California sales or use tax on or after January 1, 2000.

(E) The retailer and the lender file an election with the Board which contains the elements specified in subdivision (i)(3) and which designates either the retailer or the lender as the person entitled to claim any deduction or refund under this regulation for tax previously paid by the retailer measured by amount of the account found to be worthless and charged off. No deduction or refund can be claimed until this election is filed with the Board.

(3) ELECTION BETWEEN RETAILER AND LENDER.

(A) In order for the retailer or the lender to claim a deduction or refund for bad debt losses from an account held by the lender without recourse, the retailer and the lender must file an election with the Board designating which of them may claim such deduction or refund. The election may be in any form, including an existing contract between the retailer and the lender, so as long as the election contains the following elements:

1. The name, address, and seller's permit number of the retailer who reported or will report the tax and the name, address, and seller's permit number, if any, of the lender to whom the account(s) is assigned.

2. An agreement that the retailer relinquishes all rights to the account to the lender.

3. A statement clearly specifying whether the retailer or the lender is entitled to claim any (and all) deductions or refunds as a result of any bad debt losses charged off by the lender for the account(s) covered by the election, the effective date of that election, and a statement that the other party relinquishes all rights to claiming such deductions or refunds.

4. A list of accounts to which the election pertains. If the election is a blanket election for all accounts assigned without recourse by the retailer to the lender or all accounts held by the lender without recourse pursuant to the lender's contract directly with the retailer, the election must so state.

5. The agreement of both the retailer and the lender to furnish any and all documentation requested by the Board to support the deductions or refunds claimed.

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6. The acknowledgement by both the retailer and the lender that the Board may disclose relevant confidential information to all parties involved in order to support and confirm any deductions or refunds claimed.

7. If the lender is the person entitled to claim any deduction or refund for bad debts on the account, the Certificate of Registration – Lender account number of the lender. If the lender does not yet hold such a registration, the agreement of the lender that it will apply for the Certificate of Registration – Lender no later than on the date the lender first claims a deduction or refund for bad debts charged off on the account.

8. A statement that the election may not be amended or revoked unless a new election signed by both the retailer and the lender is filed with the Board.

9. The date of the election and the signatures of the retailer and the lender, or their authorized representatives. If a copy of the signed election is filed with the Board rather than the original, the person with the right under the election to claim the bad debt deduction or refund must retain the election with the original signatures. An election may be signed in counterparts, and its filing would be regarded as perfected as of the filing of the second signed counterpart, provided each counterpart is identical except for the signature and date of the signature. If copies of the signed counterparts are filed with the Board, the person with the right under the election to the bad debt deduction or refund must retain all counterparts with the original signatures not filed with the Board.

(B) The term “retailer” as used in this regulation (except as used in subdivisions (h) and (i)) includes a lender with respect to those accounts for which the lender is the person entitled to the bad debt deduction or claim pursuant to an election filed under this subdivision (i)(3).

(4) ELECTION BETWEEN LENDER AND AFFILIATED ENTITY OR OTHER ASSIGNEE.

(A) If a person who is a lender under subdivision (i)(1)(A) or (i)(1)(B) and who has the right to claim any deduction or refund for bad debts the lender charges off on the account wishes to assign to a person who is its affiliated entity under section 1504 of Title 26 of the United States Code or to some other assignee the right to claim any deduction or refund for the amount of bad debts charged off on the account, the lender and the affiliated entity or other assignee must file an election with the Board prior to the affiliated entity's or other assignee's claiming of any deduction or refund. The election filed with the Board may be in any form, but must include all the following elements:

1. The name, address, and seller's permit number of the retailer who reported or will report the tax; the name, address, seller's permit number, if any, and Certificate of Registration – Lender account number, if any, of the lender under subdivision (i)(1)(A) or (i)(1)(B) making the assignment; and the name, address, seller's permit number, if any, and Certificate of Registration – Lender account number, if any, of the person to whom the assignment is made under subdivision (i)(1)(C).

2. A copy of the election between the retailer and the lender under which the lender has the right to any (and all) deductions or refunds as a result of any bad debt losses charged off by the lender on the account(s). If that election has not yet been filed with the Board, then that election must be filed along with the election between the lender and its affiliated entity or other assignee. If the election with the original signature was retained by the lender rather than filing it with the

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Board, that election must either be filed with the Board or retained by the affiliated entity or other assignee.

3. A statement clearly specifying that the affiliated entity or other assignee is entitled to any (and all) deductions or refunds as a result of any bad debt losses charged off on the account(s) covered by the election and the effective date of that election, and a statement that the lender under subdivision (i)(1)(A) or (i)(1)(B) relinquishes all claims to such deductions or refunds.

4. A list of accounts to which the election pertains. If the election is a blanket election for all accounts held by the lender, the election must so state.

5. The agreement of the lender to furnish any and all documentation required by the Board to support the claiming of deductions or refunds by the affiliated entity or other assignee.

6. The acknowledgement by both the lender and its affiliated entity or other assignee that the Board may disclose relevant confidential information to all parties involved in order to support and confirm any deductions or refunds claimed.

7. If the affiliated entity or other assignee does not yet hold a Certificate of Registration - Lender, the agreement that it will apply for that certificate no later than on the date it first claims a deduction or refund for bad debts charged off on the account.

8. The acknowledgement by the affiliated entity or other assignee that it cannot further assign the right to claim a deduction or refund for bad debts charged off on the account.

9. A statement that the election may not be amended or revoked unless a new election signed by both the lender and the affiliated entity or other assignee is filed with the Board.

10. The date of the election and the signatures of the lender and the affiliated entity or other assignee, or their authorized representatives. If a copy of the signed election is filed with the Board rather than the original, the person with the right under the election to claim the bad debt deduction or refund must retain the election with the original signatures. An election may be signed in counterparts, and its filing would be regarded as perfected as of the filing of the second signed counterpart, provided each counterpart is identical except for the signature and date of the signature. If copies of the signed counterparts are filed with the Board, the person with the right under the election to the bad debt deduction or refund must retain all counterparts with the original signatures not filed with the Board.

(B) The term "retailer" as used in this regulation (except as used in subdivisions (h) and (i)) includes an entity affiliated with a lender under section 1504 of Title 26 of the United States Code, or other assignee, with respect to those accounts for which the affiliated entity or other assignee is the person entitled to the bad debt deduction or claim pursuant to an election filed under this subdivision (i)(4).

(5) REGISTRATION, RETURNS, CLAIMS FOR DEDUCTION AND REFUNDS, AND PAYMENT OF TAX.

(A) A retailer who has the right to claim deductions or refunds for bad debts charged off by a lender on an account held by that lender pursuant to an election filed under subdivision (i)(3)

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shall claim those deductions or refunds under the provisions of this regulation in the same manner as if the retailer held the account itself.

(B) Without regard to whether a lender holds a seller's permit for its own sales of tangible personal property, a lender who has the right to claim deductions or refunds for bad debts charged off on accounts pursuant to an election filed under subdivision (i)(3) and, if applicable, subdivision (i)(4), shall register with the Board for a Certificate of Registration – Lender no later than the date on which it first claims such a deduction or refund. A lender applying for a Certificate of Registration – Lender shall provide such information as required by the Board.

(C) A lender who has the right to claim deductions or refunds for bad debts charged off pursuant to an election filed under subdivision (i)(3) and, if applicable, subdivision (i)(4), is entitled to the same amount of deduction or refund, calculated in the same manner under the provisions of this regulation, as if the lender were the retailer who had sold the tangible personal property for which the retailer had reported and paid tax. If the lender has provided the name, address, and seller's permit number of the retailer responsible for paying the tax, in determining whether to grant the lender's claim for deduction or refund, the Board shall regard the retailer as having paid the applicable tax due unless the Board establishes otherwise. (Regardless of the Board's action on the lender's claim for deduction or refund, a retailer who failed to pay the applicable tax due remains liable for that tax.)

(D) A lender who claims a deduction or refund for bad debts charged off shall be liable for tax on the taxable percentage of worthless accounts subsequently collected under subdivision (d), including amounts received for the sale of accounts for which the lender has claimed a bad debt deduction or refund.

(E) A lender who has a seller's permit for its own sales of tangible personal property may not commingle the claiming of its deductions pursuant to an election under subdivision (i)(3) and, if applicable, subdivision (i)(4), with any bad debt deductions related to its own sales of tangible personal property but must instead report such deductions on a separate return or schedule in the form specified by the Board. If the lender files a schedule attached to its sales and use tax return, it may apply the amount of its deduction calculated on that separate schedule against its liability for sales and use tax. To the extent that the deduction is not fully exhausted when applied to the lender's own sales and use tax liability, the lender may file a claim for refund.

(F) The filing by a lender of a claim for deduction or refund for bad debts on accounts covered by this subdivision (i) is not valid if an election pursuant to subdivision (i)(3) and, if applicable, an election pursuant to subdivision (i)(4), has not been filed with the Board. If a lender files a claim for deduction or refund and the applicable election(s) is filed thereafter, the claim for deduction or refund will be regarded as having been filed on the date of the filing of the election(s).

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(G) A lender holding a Certificate of Registration – Lender shall file a return in a form specified by the Board to report the taxable percentage of recoveries and claim losses on accounts covered by an election pursuant to subdivision (i)(3) and, if applicable, an election pursuant to subdivision (i)(4). This return shall be filed on a quarterly basis unless otherwise specified by the Board. The return shall include the taxable percentage of the amount of any recoveries for which the lender is liable for tax under subdivision (i)(5)(D). The lender may offset the amount of tax for which it would otherwise be entitled to a bad debt refund for the reporting period against the amount of tax for which it is liable for the taxable percentage of recoveries received during that same reporting period. The lender must file a return without regard to whether the lender received any net recoveries of previously claimed bad debts in the filing period. If the lender files a return under a seller's permit it holds for its own sales of tangible personal property, the lender must file a separate schedule to report the taxable percentage of its bad debt recoveries and losses on accounts covered by an election pursuant to subdivision (i)(3) and, if applicable, an election pursuant to subdivision (i)(4), in a form specified by the Board, as an attachment to the lender's sales and use tax return rather than filing a separate return for such recoveries and losses.

(H) A lender claiming a deduction or refund for bad debts, or reporting tax on recoveries for accounts for which it previously claimed a bad debt deduction or refund, must properly allocate the local and district taxes. If the transactions were approved by the lender on a transaction-by-transaction basis or the lender has the necessary information to do so, local and district taxes should be allocated on an actual basis. The lender may allocate local and district taxes related to all other accounts on a pro-rata basis subject to approval by the Board which approval shall not be unreasonably withheld.

Regulation 1642. Bad Debts.

Appendix 1

EXAMPLE OF COMPUTING ALLOWABLE LOSS USING PRO RATA METHOD**I. Repossession Loss Per Records:**

a. Rate.....	6%
b. Sales price of car(*).....	\$9,000 (1)
c. (1) Sales tax.....	540
(2) License fees.....	160
(3) Insurance.....	300
d. Total cash selling price	\$10,000
e. Down payment.....	2,000 (2)
f. Cash sales balance.....	\$8,000
g. Finance charges.....	1,600
h. Contract balance.....	\$9,600
i. Payments on contract.....	1,900
j. Contract balance at date of repossession.....	\$7,700
m. Unearned finance charges.....	\$1,200
n. Insurance rebate.....	100
"Net Payoff".....	1,300
o. Value of repossession.....	\$6,400
p. Repossession loss per records.....	\$5,000
	\$1,400

II. Deductible Percentage of Loss:**a. Allocation of Down Payment:**

Sales price of car.....	\$9,000
Total cash selling price.....	\$10,000
Less insurance rebate.....	100
Net Cash Price.....	\$9,900 (3)
$\$9,000 (1) \times \$2,000 (2) =$	\$1,818
	\$9,900 (3)

b. Unpaid Balance of Car:

Sales price of car	\$9,000
Less down payment.....	1,818
Unpaid balance of car.....	\$7,182 (4)
Contract balance.....	\$9,600
Less: Unearned finance.....	\$1,200
Insurance rebate.....	100
Balance.....	1,300
	\$8,300 (5)

c. Deductible Percentage of Loss:

$\$7,182 (4) = 86.53\%$ (taxable portion of loss)
$\$8,300 (5)$

III. Allowable Deduction:

$\$1,400 \times 86.53\% = \$1,211$ (allowable deduction)
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NOTE: The letters 'k' and 'l' have been omitted from the example of computation of loss since they refer to information not used in this example.

(*)Includes miscellaneous charges such as "undersealing," "documentary fees," and "smog control certification."

Regulation 1642. Bad Debts.**Staff and Industry's Proposed Appendix 1****EXAMPLE OF COMPUTING ALLOWABLE BAD DEBT DEDUCTION FOR A REPOSSESSED VEHICLE USING PRO RATA METHOD*****I. Step One. Compute the Repossession Loss Per Records***

a.	Retail sales price		\$12,000	
b.	Taxable fees (i.e., doc/smog)		<u>230</u>	
c.	Total amount subject to tax		12,230	(a+b)
d.	Sales Tax (6%)	734		(c*.06)
e.	License Fees	240		
f.	Other non-taxables	<u>0</u>		
g.	Total non-taxable charges		<u>974</u>	(d+e+f)
h.	Total sales price		13,204	(c+g)
i.	Down payment		<u>2,000</u>	
j.	Balance on contract		11,204	(h-i)
k.	Finance charges/accrued interest		<u>3,000</u>	
l.	Total contract value		14,204	(j+k)
m.	Payments received on contract		<u>2,100</u>	
n.	Balance on date of repossession		12,104	(l-m)
o.	Unearned finance charges		<u>2,750</u>	
p.	Net contract balance		9,354	(n-o)
q.	Value of repossession		<u>6,000</u>	
r.	Repossession loss per records		<u>\$3,354</u>	

II. Step Two. Compute the Taxable Percentage of Loss.

This is done by dividing the total amount subject to tax (line c) by the total sales price (line h).

$$12,230 / 13,204 = 92.62\%.$$

III. Step Three. Compute the Allowable Deduction.

This is done by multiplying the taxable percentage of loss (step Two) by the repossession loss per records (step One).

$$92.62\% * 3,354 = \underline{\$3,106.47}$$

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Appendix 2

~~CONSOLIDATION OF ALLOWABLE BAD DEBT DEDUCTION FOR REPOSSESSED
MERCHANDISE USING PRO RATA METHOD~~~~(6% Sales)~~

		(1)				(2)	(3)			(4)	<u>Less</u>		(5)
Date of Repos- Session	Car #	Sales Price of Mdse.	Sales Tax (6%)	License Fee	Insurance (Net)	Net Cash Sales Price	Down Payment	Balance to Finance	Finance Charges (Net)	Net Contract Balance	Payments	Value of Repos- session	Repos- session Loss Per Records
		(A)						(B)					
9-30-78	507	\$9,000	\$540	\$160	\$200	\$9,900	\$2,000	\$7,900	\$400	\$8,300	\$1,900	\$5,000	\$1,400
10-27-78	521	8,000	480	140	160	8,780	1,700	7,080	350	7,430	1,650	4,400	1,380
11-4-78	540	6,000	360	110	120	6,590	1,300	5,290	260	5,550	1,250	3,300	1,000
12-9-78	575	<u>5,000</u>	<u>300</u>	<u>90</u>	<u>100</u>	<u>5,490</u>	<u>1,100</u>	<u>4,390</u>	<u>200</u>	<u>4,590</u>	<u>1,000</u>	<u>2,700</u>	<u>890</u>
Totals		<u>\$28,000</u>	<u>\$1,680</u>	<u>\$500</u>	<u>\$580</u>	<u>\$30,760</u>	<u>\$6,100</u>	<u>\$24,660</u>	<u>\$1,210</u>	<u>\$25,870</u>	<u>\$5,800</u>	<u>\$15,400</u>	<u>\$4,670</u>

~~Computation of allocation of down payment to merchandise.~~

$$\frac{\$28,000^{(1)}}{\$30,760^{(2)}} \times \$6,100^{(3)} = \$5,553$$

~~Computation of allowable bad debt deduction.~~

$$\frac{\$28,000^{(1)} - \$5,553}{\$25,870^{(4)}} \times \$4,670^{(5)} = \$4,052$$

^(A) Original insurance charge less rebate of unearned premium.^(B) Total finance charges per contract less unearned charges.

Regulation 1642. Bad Debts.**Appendix 2**

**CONSOLIDATION OF ALLOWABLE BAD DEBT DEDUCTION FOR MULTIPLE
REPOSSESSED VEHICLES USING PRO RATA METHOD**

(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)	(J)	(K)	(L)	(M)	(N)
Date of Repos- session	Car #	Sales Price of Mdse ^A	Sales Tax (6%)	License Fee	Insurance (Net) ^B	Total Sales Price	Down Payment	Balance to Finance	Finance Charges (Net) ^C	Net Contract Balance	Payments	Value of Repos- session	Repos- session Loss Per Records
			[C*.06]		[C...F]		[G-H]		[I+J]		[K-L-M]		
09-30-00	507	\$9,000	\$540	\$160	\$200	\$9,900	\$2,000	\$7,900	\$400	\$8,300	\$1,900	\$5,000	\$1,400
10-27-00	521	8,000	480	140	160	8,780	1,700	7,080	350	7,430	1,650	4,400	1,380
11-04-00	540	6,000	360	110	120	6,590	1,300	5,290	260	5,550	1,250	3,300	1,000
12-09-00	575	<u>5,000</u>	<u>300</u>	<u>90</u>	<u>100</u>	<u>5,490</u>	<u>1,100</u>	<u>4,390</u>	<u>200</u>	<u>4,590</u>	<u>1,000</u>	<u>2,700</u>	<u>890</u>
Totals		<u>\$28,000</u>	<u>\$1,680</u>	<u>\$500</u>	<u>\$580</u>	<u>\$30,760</u>	<u>\$6,100</u>	<u>\$24,660</u>	<u>\$1,210</u>	<u>\$25,870</u>	<u>\$5,800</u>	<u>\$15,400</u>	<u>\$4,670</u>
		(1)			(2)	(3)			(4)	(5)			

<i>Computation of allocation of down payment to merchandise.</i>	<i>Computation of allowable bad debt deduction.</i>
$\frac{\$28,000^{(1)}}{\$30,760^{(2)}} \times \$6,100^{(3)} = \$5,553$	$\frac{\$28,000^{(1)} - \$5,553}{\$25,870^{(4)}} \times \$4,670^{(5)} = \$4,052$

^A Includes taxable amounts, such as doc and smog fees.

^B Original insurance charge less rebate of unearned premium.

^C Total finance charges per contract less unearned charges.

Revenue and Taxation Code Sections 6055 & 6203.5
As Amended by AB 599 (Chap. 600) Stats. of 2000

THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

SECTION 1. Section 6055 of the Revenue and Taxation Code is amended to read:

6055. (a) A retailer is relieved from liability for sales tax that became due and payable, insofar as the measure of the tax is represented by accounts that have been found to be worthless and charged off for income tax purposes by the retailer or, if the retailer is not required to file income tax returns, charged off in accordance with generally accepted accounting principles. A retailer that has previously paid the tax may, under rules and regulations prescribed by the board, take as a deduction the amount found worthless and charged off by the retailer. If these accounts are thereafter in whole or in part collected by the retailer, the amount collected shall be included in the first return filed after the collection and the tax shall be paid with the return. For purposes of this subdivision, the term "retailer" shall include any entity affiliated with the retailer under Section 1504 of Title 26 of the United States Code.

(b) (1) In the case of accounts held by a lender, a retailer or lender who makes a proper election under paragraph (4) shall be entitled to a deduction or refund of the tax that the retailer has previously reported and paid if all of the following conditions are met:

(A) No deduction was previously claimed or allowed on any portion of the accounts.

(B) The accounts have been found worthless and written off by the lender in accordance with the requirements of subdivision (a).

(C) The contract between the retailer and the lender contains an irrevocable relinquishment of all rights to the account from the retailer to the lender.

(D) The retailer remitted the tax on or after January 1, 2000.

(E) The party electing to claim the deduction or refund under paragraph (4) files a claim in a manner prescribed by the board.

(2) If the retailer or the lender thereafter collects in whole or in part any accounts, one of the following shall apply:

(A) If the retailer is entitled to the deduction or refund under the election specified in paragraph (4), the retailer shall include the amount collected in its first return filed after the collection and pay tax on that amount with the return.

(B) If the lender is entitled to the deduction or refund under the election specified in paragraph (4), the lender shall pay the tax to the board in accordance with Section 6451.

(3) For purposes of this subdivision, the term "lender" means any of the following:

(A) Any person who holds a retail account which that person purchased directly from a retailer who reported the tax.

(B) Any person who holds a retail account pursuant to that person's contract directly with the retailer who reported the tax.

(C) Any person who is either an affiliated entity, under Section 1504 of Title 26 of the United States Code, of a person described in subparagraph (A) or (B), or an assignee of a person described in subparagraph (A) or (B).

(4) Prior to claiming any deduction or refund under this subdivision, the retailer who reported the tax and the lender shall file an election with the board, signed by both parties, designating which party is entitled to claim the deduction or refund. This election may not be amended or revoked unless a new election, signed by both parties, is filed with the board.

SEC. 2. Section 6203.5 of the Revenue and Taxation Code is amended to read:

6203.5. (a) A retailer is relieved from liability to collect use tax that became due and payable, insofar as the measure of the tax is represented by accounts that have been found to be worthless and charged off for income tax purposes by the retailer or, if the retailer is not required to file income tax returns, charged off in accordance with generally accepted accounting principles. A retailer that has previously paid the amount of the tax may, under rules and regulations prescribed by the board, take as a deduction the amount found worthless and charged off by the retailer. If these accounts are thereafter in whole or in part collected by the retailer, the amount collected shall be included in the first return filed after the collection and the amount of the tax shall be paid with the return. For purposes of this subdivision, the term "retailer" shall include any entity affiliated with the retailer under Section 1504 of Title 26 of the United States Code.

(b) (1) In the case of accounts held by a lender, a retailer or lender who makes a proper election under paragraph (4) shall be entitled to a deduction or refund of the tax that the retailer has previously reported and paid if all of the following conditions are met:

(A) No deduction was previously claimed or allowed on any portion of the accounts.

(B) The accounts have been found worthless and written off by the lender in accordance with the requirements of subdivision (a).

(C) The contract between the retailer and the lender contains an irrevocable relinquishment of all rights to the account from the retailer to the lender.

(D) The retailer remitted the tax on or after January 1, 2000.

(E) The party electing to claim the deduction or refund under paragraph (4) files a claim in a manner prescribed by the board.

(2) If the retailer or the lender thereafter collects in whole or in part any accounts, one of the following shall apply:

(A) If the retailer is entitled to the deduction or refund under the election specified in paragraph (4), the retailer shall include the amount collected in its first return filed after the collection and pay tax on that amount with the return.

(B) If the lender is entitled to the deduction or refund under the election specified in paragraph (4), the lender shall pay the tax to the board in accordance with Section 6451.

(3) For purposes of this subdivision, the term "lender" means any of the following:

(A) Any person who holds a retail account which that person purchased directly from a retailer who reported the tax.

(B) Any person who holds a retail account pursuant to that person's contract directly with the retailer who reported the tax.

(C) Any person who is either an affiliated entity, under Section 1504 of Title 26 of the United States Code, of a person described in subparagraph (A) or (B), or an assignee of a person described in subparagraph (A) or (B).

(4) Prior to claiming any deduction or refund under this subdivision, the retailer who reported the tax and the lender shall file an election with the board, signed by both parties, designating which party is entitled to claim the deduction or refund. This election may not be amended or revoked unless a new election, signed by both parties, is filed with the board.